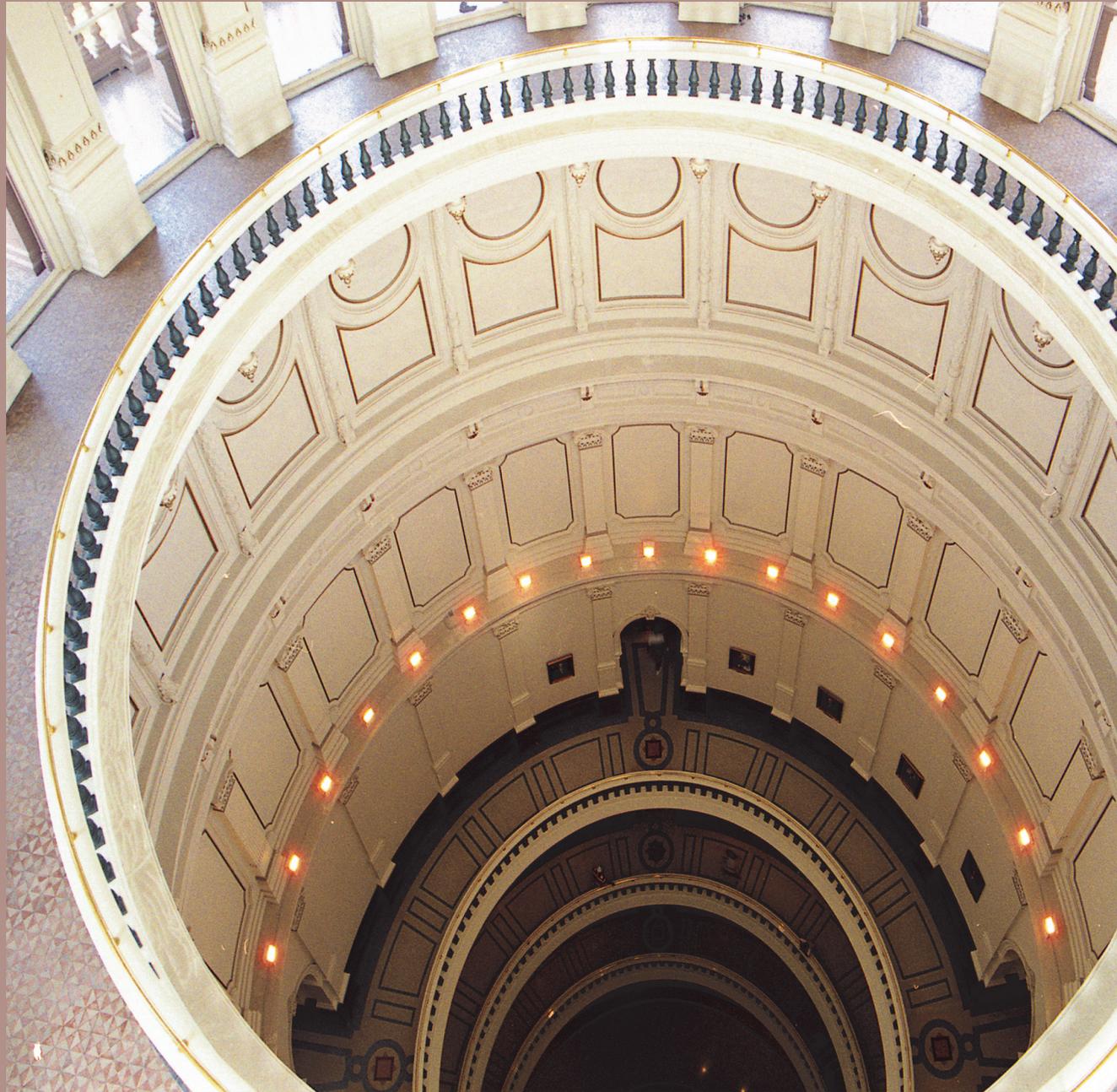


Annual Report on Major State Investment Funds

FISCAL YEAR 2006



LEGISLATIVE BUDGET BOARD

Annual Report on Major State Investment Funds

FISCAL YEAR 2006

LEGISLATIVE BUDGET BOARD

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LEGISLATIVE BUDGET BOARD

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July 25, 2007

The Honorable David Dewhurst
The Honorable Tom Craddick
Members of the Eightieth Legislature

Dear Governor Dewhurst, Speaker Craddick, and Members:

As required by the provisions of Sec. 322.014, Texas Government Code, this report reviews the risk-adjusted performance of the following major state investment funds:

Teacher Retirement System Pension Trust Fund

Permanent School Fund

Employees Retirement System Pooled Pension Trust Funds

The University of Texas System
Permanent Health Fund
Permanent University Fund

Comptroller of Public Accounts
Tobacco Settlement Permanent Trust Fund
Texas Guaranteed Tuition Plan Fund
Permanent Public Health Fund
Permanent Higher Education Fund

The report makes no recommendations regarding portfolio allocations or current management practices. It is intended as an informational resource only.

The LBB staff who developed and produced the report are Emily Brownlow, Melissa Nelson, Curtis Toews, Scott Dudley, and Kim Irby.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "John O'Brien".

John O'Brien
Director

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EXECUTIVE SUMMARY

The fiscal year 2006 Annual Report on Major State Investment Funds presents the financial performance for Texas' major investment funds. The report includes the risk-adjusted returns for the funds, as well as other performance and background information for each of the funds. The investing agencies or institutions of higher education provided information in the report either by direct submission (see attachments in Appendix D) or by published annual reports. The only information the Legislative Budget Board (LBB) staff calculated is the risk-adjusted return and the five-year average total fund rate of return. The report does not include recommendations regarding portfolio allocations or current management practices. It should serve as an information resource only.

ECONOMIC/INVESTMENT ENVIRONMENT

Fiscal year 2006 was a good year for both the Texas and the U.S. economies. The Texas gross product increased 7.7 percent, and Texas personal income increased by 8.1 percent. The U.S. economy did nearly as well as the Texas economy. The U.S. gross product increased by 5.7 percent, and U.S. personal income grew by 6.6 percent. In Texas, the value of output from the mining sector (specifically oil and natural gas activities) grew nearly 20 percent, while the output of business services and construction (primarily nonresidential construction) increased 10 percent. The laggard of the Texas economy was the agriculture, forestry, and fishing sector, which decreased 5.2 percent. However, at the national level, a surge in business investment and exports to foreign countries comprised the economic growth.

The Standard & Poor (S&P) 500 (an index of the 500 largest corporations, most of which are based in the U.S.) increased 6.8 percent in 2006, while the Wilshire 5000 (a broad stock market index of the U.S.) increased 8.6 percent. 2006 was the fourth year of stock market index gains following three years of declines resulting from the collapse of the high-tech bubble, the events of September 11, 2001, and the run-up to the invasion of Iraq. Significant growth in equity markets in 2006 occurred overseas, where many market indices increased by double digits. The Nikkei 225 (a measure of the Japanese stock exchange) increased 30 percent from the end of August 2005 to the beginning of September 2006. The Seoul Composite index (a measure of the South Korean stock exchange) increased 25.2 percent over a similar period. The FTSE index (a measure of the London Stock Exchange) rose by 12.3 percent.

In 2006, the yields on 10-year U.S. Treasury notes gradually increased, but remained historically low, averaging 4.76 percent for the year. These rates resulted from market expectations of low and stable price inflation. During the year, overall consumer prices rose 3.4 percent, mainly because of increases in energy prices. The consumer price index, excluding prices for the volatile food and energy sectors, rose

only 2.8 percent. Though price inflation appeared slight, the Federal Reserve became concerned about the prospect of future, accelerating increases in prices. This concern became apparent with the Federal Reserve increasing the discount rate (i.e., the interest rate at member banks of the Federal Reserve Bank system may borrow short term funds directly from a Federal Reserve Bank). On September 20, 2006, the Federal Reserve raised the discount rate from 4.50 percent to 4.75 percent.

Energy prices rose in 2005 and accelerated their rise in 2006. The 2005 average spot market price for natural gas was \$7 per thousand cubic feet (MCF) in 2005 and rose over an \$8 per MCF in 2006. The price for crude oil in 2005 was slightly over \$53 per barrel and slightly over \$66 per barrel in 2006. Throughout the year, public and private investors searched for higher rates of return by purchasing higher risked assets, such as smaller cap, energy, and foreign or emerging nation stocks or high yield corporate and government debt issues.

ENDING MARKET VALUE

The fiscal year 2006 ending market value of the major state investment funds was \$162.7 billion, an increase of \$11.8 billion more than the 2005 ending market value. The funds and their ending market values are shown in **Table 1**.

RATES OF RETURN

All funds earned positive rates of return for fiscal year 2006, increasing on average 10.0 percent, reflecting the improved economic and financial environment for the year. As **Table 2** shows, the rates of return range from 8.7 percent to 11.6 percent.

The total fund rate of return used in this report is the gross time-weighted rate of return for all investments of each fund. The rate is calculated before related investment expenses are deducted, and is adjusted to eliminate the effect of timing of cash flows due to contributions and withdrawals. The five-year average rate of return is calculated using a geometric average of the annual rates of return for the five-year period.

**TABLE 1
ENDING MARKET VALUE
FISCAL YEAR 2006**

| FUND | VALUE (IN BILLIONS) |
|--|------------------------|
| Teacher Retirement System Pension Trust Fund | \$101.3 |
| Permanent School Fund | 22.9 |
| Employees Retirement System Pension Trust Fund | 22.4 |
| Permanent University Fund | 10.3 |
| Permanent Health Fund | 1.0 |
| Tobacco Settlement Permanent Trust Fund | 2.2 |
| Texas Guaranteed Tuition Plan Fund | 1.7 |
| Permanent Public Health Fund | 0.5 |
| Permanent Higher Education Fund | 0.5 |
| Total Investment Funds | \$162.7 |

NOTE: Values are calculated on actual amounts before rounding. Therefore, the table amounts may not add because of rounding.
SOURCE: Investing agencies and institutions of higher education.

**TABLE 2
ANNUAL RATE OF RETURN
FISCAL YEAR 2006**

| FUND | RATE OF RETURN | |
|--|----------------|-----------|
| | TIME WEIGHTED | BENCHMARK |
| Teacher Retirement System Pension Trust Fund | 9.7% | 9.3% |
| Permanent School Fund | 10.4 | 9.8 |
| Employees Retirement System Pension Trust Fund | 8.8 | 9.0 |
| Permanent University Fund | 11.6 | 12.5 |
| Permanent Health Fund | 11.1 | 12.5 |
| Tobacco Settlement Permanent Trust Fund | 10.2 | 10.4 |
| Texas Guaranteed Tuition Plan Fund | 8.7 | 8.5 |
| Permanent Public Health Fund | 9.9 | 10.4 |
| Permanent Higher Education Fund | 9.7 | 10.4 |

NOTES: Performance benchmarks were calculated by the agencies or institutions and are identified in the background information provided for each fund in Appendix B.
Each fund has different investment objectives and strategies, some required by law, that impact its benchmarks and performance.
SOURCE: Investing agencies and institutions of higher education.

(Prior to fiscal year 2003, averages were calculated using a mathematical average. Investing agencies and institutions of higher education provide annual rates.)

The annual rates of return reflect both income earned and change in fund value, without consideration of the risk of fund investments. **Table 3** shows the average rates of return over five years.

**TABLE 3
AVERAGE RATES OF RETURN
FISCAL YEARS 2002 TO 2006**

| FUND | FIVE-YEAR PERIOD RATE OF RETURN |
|--|------------------------------------|
| Teacher Retirement System Pension Trust Fund | 7.58% |
| Permanent School Fund | 7.54 |
| Employees Retirement System Pension Trust Fund | 6.79 |
| Permanent University Fund | 9.72 |
| Permanent Health Fund | 9.68 |
| Tobacco Settlement Permanent Trust Fund | 7.87 |
| Texas Guaranteed Tuition Plan Fund | 7.21 |
| Permanent Public Health Fund | 7.58 |
| Permanent Higher Education Fund | 7.68 |

NOTE: Each fund has different investment objectives and strategies, some required by law, that impact its benchmarks and performance.
SOURCE: Investing agencies and institutions of higher education.

RISK-ADJUSTED RETURN

The risk-adjusted return compares the performance of funds that have different types and proportions of assets, and quantifies a fund's return relative to its risk. The Sharpe ratio is a method for determining the risk-adjusted return for each fund. (The calculation of the Sharpe ratio is explained below.) As **Table 4** shows, the returns range from 0.53 percent to 0.77 percent.

A risk-adjusted return is a single statistic that reflects both the return and volatility of returns over time. A generally accepted measure for computing the risk-adjusted return is the "Sharpe ratio," developed by Nobel Laureate William Sharpe. The Sharpe ratio is often used to rank the risk-adjusted performance of various portfolios over the same period. The results of the Sharpe ratio indicate the amount of return earned per unit of risk.

TABLE 4
RISK-ADJUSTED RETURN
FISCAL YEARS 2002 TO 2006

| FUND | FIVE-YEAR PERIOD RATE OF RETURN |
|--|------------------------------------|
| Teacher Retirement System Pension Trust Fund | 0.61% |
| Permanent School Fund | 0.66 |
| Employees Retirement System Pension Trust Fund | 0.57 |
| Permanent University Fund | 0.76 |
| Permanent Health Fund | 0.77 |
| Tobacco Settlement Permanent Trust Fund | 0.61 |
| Texas Guaranteed Tuition Plan Fund | 0.76 |
| Permanent Public Health Fund | 0.54 |
| Permanent Higher Education Fund | 0.53 |

SOURCE: Investing agencies and institutions of higher education.

The formula for the Sharpe ratio follows:

$$\frac{\left(\text{Portfolio's Total Return} \right) - \left(\text{"Risk-free" Rate of 90-day Treasury Bills} \right)}{\left(\text{Standard Deviation of the Portfolio's Return Over Time} \right)}$$

For example, compare two portfolios, both with average annualized returns of 10 percent over the past five years. In one portfolio, the growth consistently, year after year, fell within a tight range of 7 percent to 12 percent. The performance of this portfolio would reflect a higher (better) risk-adjusted return than the other portfolio that averaged the same 10 percent annualized return, but varied wildly year to year ("higher volatility"), with returns ranging from losses of 20 percent to extraordinary gains of 50 percent. Risk-adjusted returns should only be calculated for a minimum period of three years because the statistic is unreliable for a single year calculation. For purposes of this report, the Sharpe ratio is calculated by using a five-year period of returns.

The Sharpe ratio is a figure used for comparative purposes, and does not reflect different investment objectives and restrictions, which legitimately produce different investment strategies and results for different funds.

The total return amounts used in the calculations were provided to the LBB staff by the entities responsible for investing the funds. The annual rates used for the risk-free

rate of the 90-day U.S. Treasury Bill are from the Merrill Lynch 90-day U.S. Treasury Bill Index, as provided by The University of Texas Investment Management Company. The five-year average risk-free rate used in the calculation is 2.3 percent compared to 2.5 percent from last year.

USE OF EXTERNAL MANAGERS/ADVISORS FOR INVESTMENTS

Each of the funds varies in its use of external managers or advisors to invest its assets. All investments of the Teacher Retirement System Pension Trust Fund are managed internally, and all the investments of the Texas Guaranteed Tuition Plan Fund are managed externally. The remaining funds use a mix of internal and external managers. **Table 5** lists the portion of assets managed internally and externally for fiscal year 2006.

TABLE 5
PERCENTAGE OF ASSETS INTERNALLY AND EXTERNALLY MANAGED
FISCAL YEAR 2006

| FUND | PERCENTAGE OF FUND BALANCE | |
|--|----------------------------|----------|
| | INTERNAL | EXTERNAL |
| Teacher Retirement System Pension Trust Fund | 100.0% | 0.0% |
| Permanent School Fund | 80.3 | 19.7 |
| Employees Retirement System Pension Trust Fund | 64.4 | 35.6 |
| Permanent University Fund | 25.0 | 75.0 |
| Permanent Health Fund | 25.0 | 75.0 |
| Tobacco Settlement Permanent Trust Fund | 4.0 | 96.0 |
| Texas Guaranteed Tuition Plan Fund | 0.0 | 100.0 |
| Permanent Public Health Fund | 3.9 | 96.1 |
| Permanent Higher Education Fund | 4.0 | 96.0 |

NOTE: The UT-PHF assets are invested in the University of Texas System General Endowment Fund (GEF). The above percentages reflect the allocation of the GEF assets.

SOURCE: Investing agencies and institutions of higher education.

RATES OF RETURN FOR DOMESTIC EQUITY INVESTMENTS

Each of the funds has a significant amount invested in domestic equity investments. The two benchmarks for this asset group are the Standard & Poor’s (S&P) 500 Composite Index and the S & P’s 1500 Composite Index. The S&P 500 Composite Index is the investment industry’s standard for measuring the performance of actual portfolios. It is a market-value-weighted index of 500 stocks that are traded on the New York Stock Exchange, American Stock Exchange, and the NASDAQ National Market System. The second benchmark is the S&P 1500 Composite Index, which measures the performance of the top 1500 U.S. companies.

Table 6 lists the rates of returns for domestic equity investments for fiscal year 2006. As applicable, the rates are shown for investments managed by external managers and for investments managed internally.

**TABLE 6
RATES OF RETURN FOR DOMESTIC EQUITY INVESTMENTS
FISCAL YEAR 2006**

| FUND | RATES OF RETURN | |
|--|-----------------|----------|
| | INTERNAL | EXTERNAL |
| BENCHMARKS | | |
| Standard & Poor’s 500 Index | 8.9% | 8.9% |
| Standard & Poor’s 1500 Index | 8.7 | 8.7 |
| Teacher Retirement System Pension Trust Fund | 12.1 | NA |
| Permanent School Fund | 8.5 | NA |
| Employees Retirement System Pension Trust Fund | 10.0 | 5.3 |
| Permanent University Fund | 11.9 | 9.6 |
| Permanent Health Fund | 12.9 | 9.5 |
| Tobacco Settlement Permanent Trust Fund | NA | 13.0 |
| Texas Guaranteed Tuition Plan Fund | NA | 7.6 |
| Permanent Public Health Fund | NA | 13.2 |
| Permanent Higher Education Fund | NA | 13.7 |

NOTE: NA = funds that do not have domestic equity investments for the category shown. The UT-PHF assets are invested in the University of Texas System General Endowment Fund (GEF). The above percentages reflect the allocation of the GEF assets.
SOURCE: Investing agencies and institutions of higher education.

ACRONYMS

Acronyms used throughout this report follow:

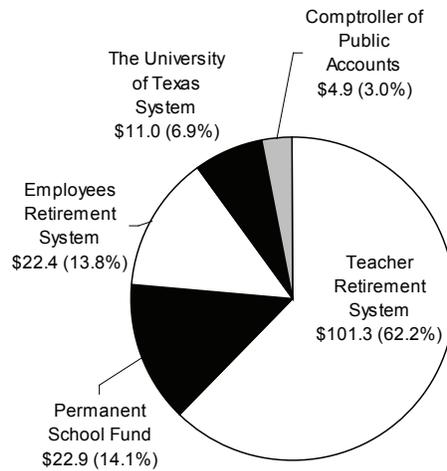
- The University of Texas System – UT
- Texas Education Agency – TEA
- State Board of Education – SBOE
- Employees Retirement System – ERS
- Teacher Retirement System – TRS
- Comptroller of Public Accounts – CPA
- Permanent School Fund – PSF
- Permanent University Fund – PUF
- Permanent Health Fund – PHF
- Tobacco Settlement Fund – TSF
- Texas Guaranteed Tuition Plan Fund – TGTF
- Permanent Public Health Fund – PPHF
- Permanent Higher Education Fund – PHEF

ALL MAJOR FUNDS

**ENDING MARKET VALUES
FISCAL YEAR ENDING AUGUST 31, 2006**

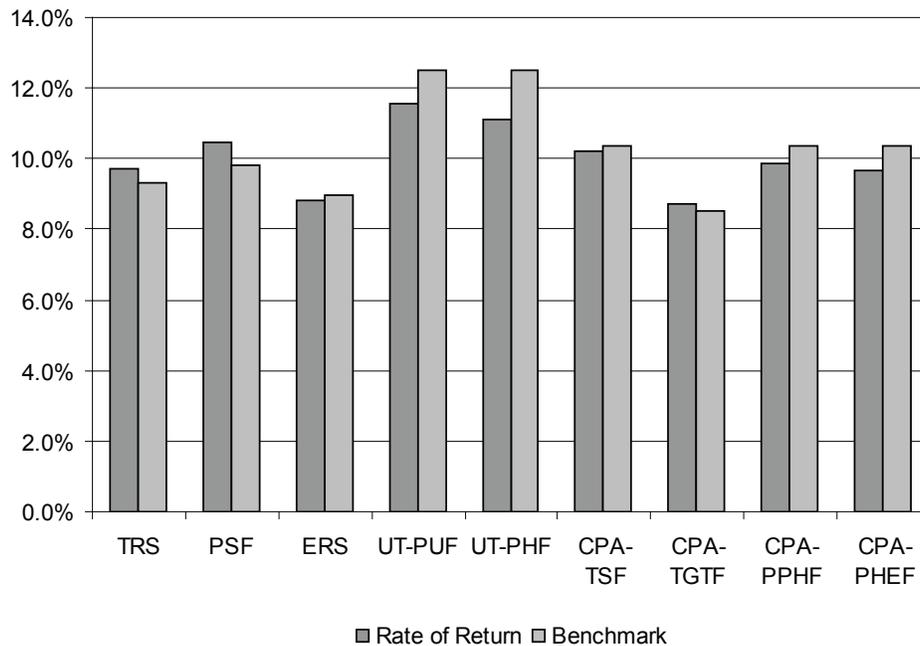
IN BILLIONS

TOTAL = \$162.7 BILLION



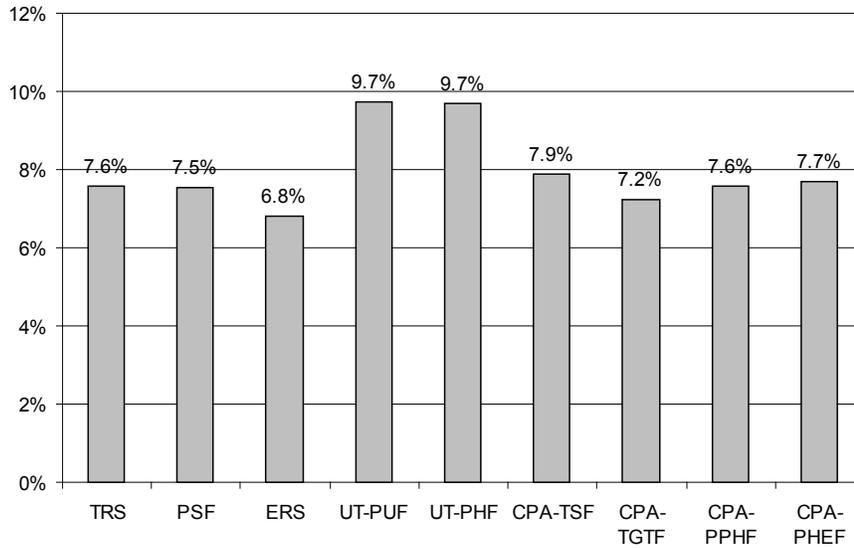
NOTES: The University of Texas System amounts include the Permanent University Fund and the Permanent Health Fund. Comptroller of Public Accounts amounts include the Tobacco Settlement Fund, the Texas Guaranteed Tuition Plan Fund, the Permanent Public Health Fund, and the Permanent Higher Education Fund.

**TOTAL RATES OF RETURN AND BENCHMARKS
FISCAL YEAR 2006**

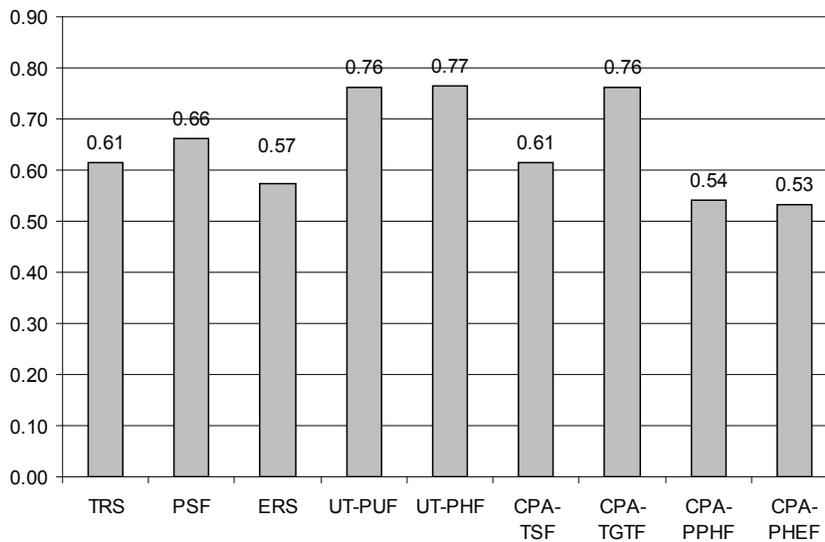


ALL MAJOR FUNDS

**AVERAGE TOTAL FUND RATES OF RETURN
FIVE-YEAR PERIOD ENDING AUGUST 31, 2006**

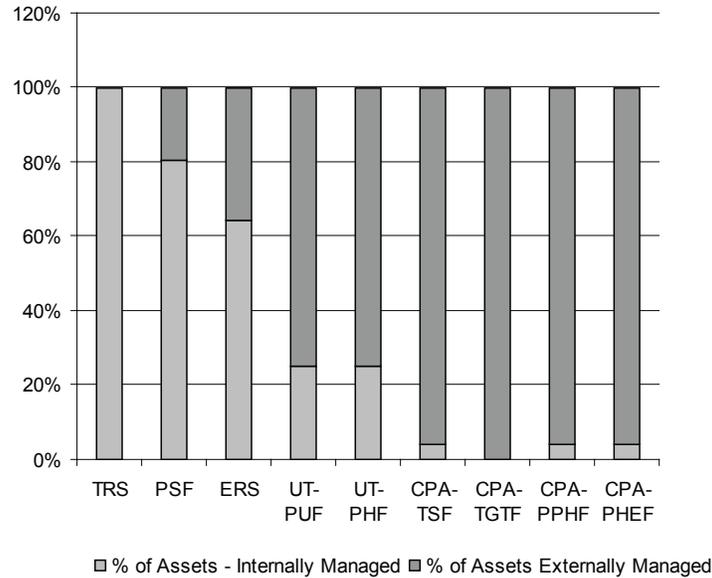


**RISK-ADJUSTED RATES OF RETURN
FIVE-YEAR PERIOD ENDING AUGUST 31, 2006**



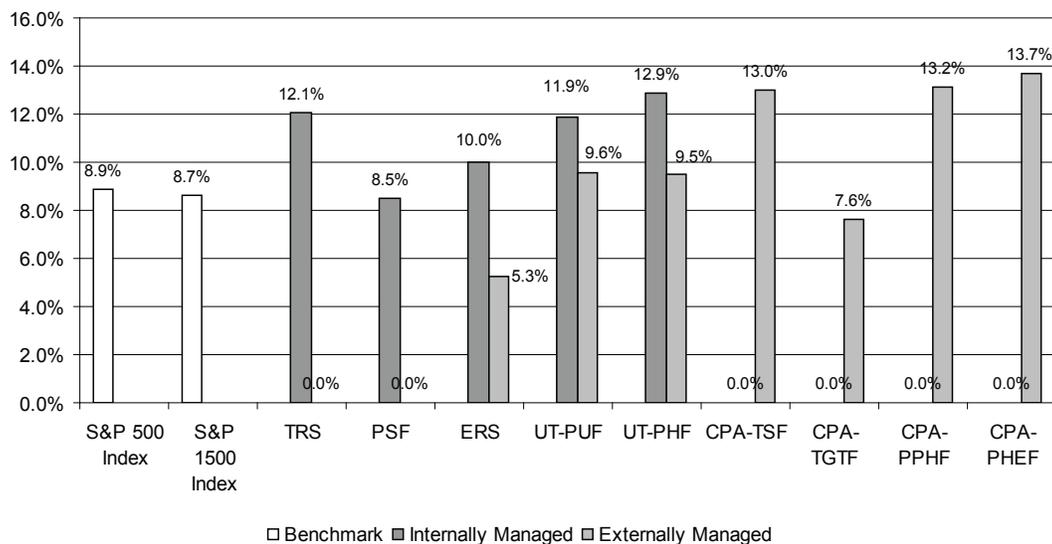
ALL MAJOR FUNDS

**PORTION OF ASSETS INTERNALLY AND EXTERNALLY MANAGED
FISCAL YEAR 2006**



NOTE: The UT-PHF assets are invested in the University of Texas System General Endowment Fund (GEF). The above percentages reflect the allocation of the GEF assets.

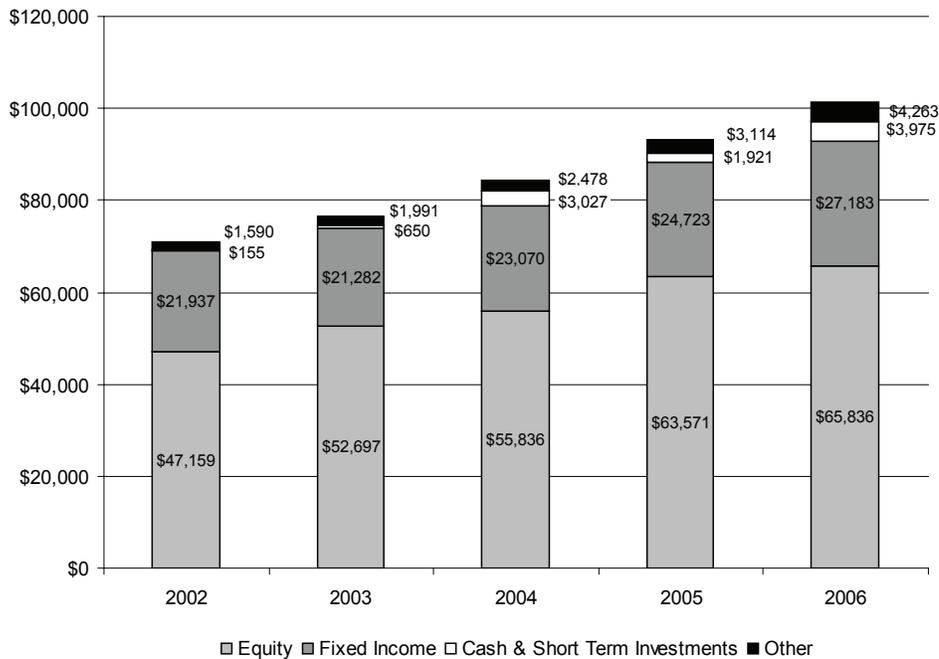
**RATES OF RETURN FOR DOMESTIC EQUITIES
FISCAL YEAR 2006**



NOTE: TRS manages all equity investments internally. CPA equity investments are all managed externally. The UT-PHF assets are invested in the University of Texas System General Endowment Fund (GEF). The above percentages reflect the allocation of the GEF assets.

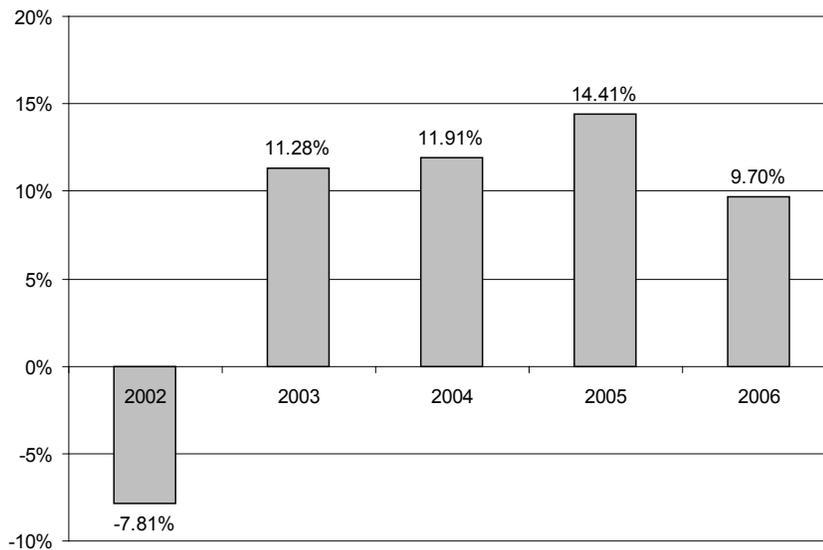
TEACHER RETIREMENT SYSTEM—PENSION TRUST FUND

PORTFOLIO DIVERSIFICATION ENDING MARKET VALUES FISCAL YEARS 2002 TO 2006



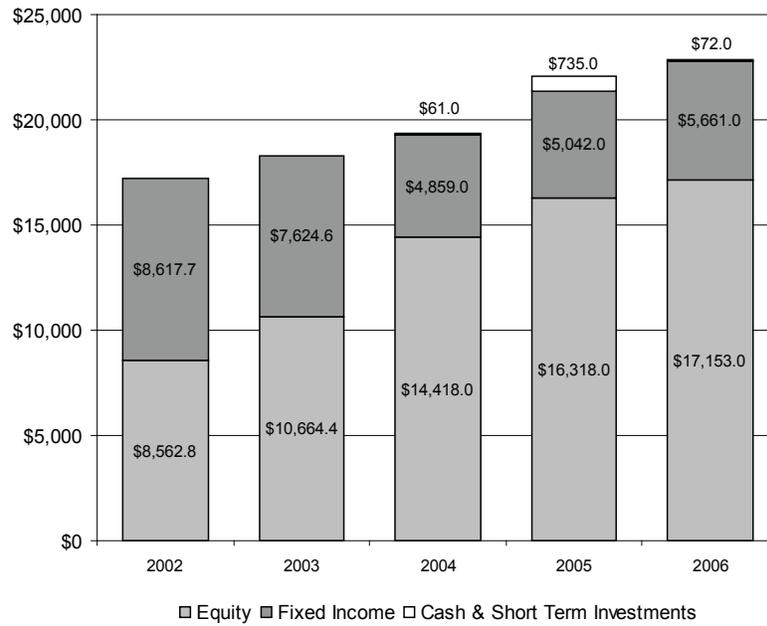
NOTES: Other Investments include limited partnerships in private domestic equity, private international equity, domestic real estate, and domestic strategically traded investments.

ANNUAL TOTAL RATES OF RETURN FISCAL YEARS 2002 TO 2006

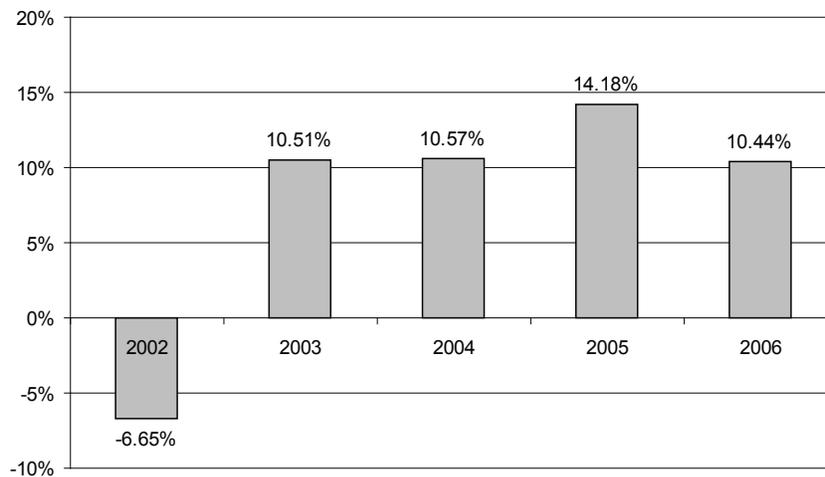


PERMANENT SCHOOL FUND

PORTFOLIO DIVERSIFICATION ENDING MARKET VALUES FISCAL YEARS 2002 TO 2006

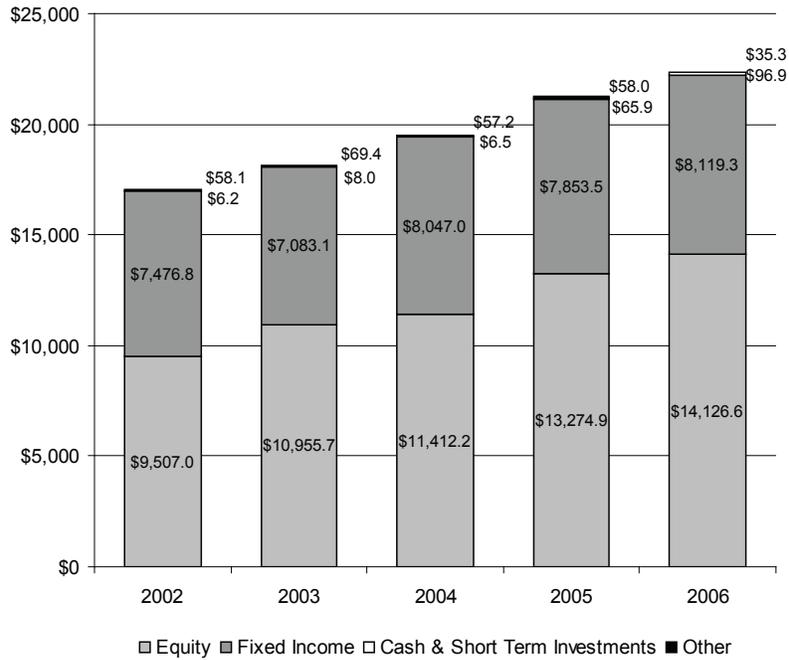


ANNUAL TOTAL RATES OF RETURN FISCAL YEARS 2002 TO 2006

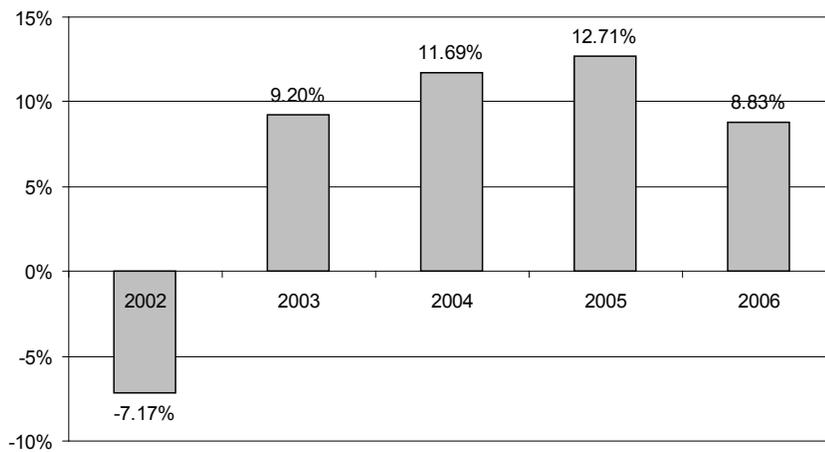


EMPLOYEES RETIREMENT SYSTEM—PENSION TRUST FUND

PORTFOLIO DIVERSIFICATION ENDING MARKET VALUES FISCAL YEARS 2002 TO 2006

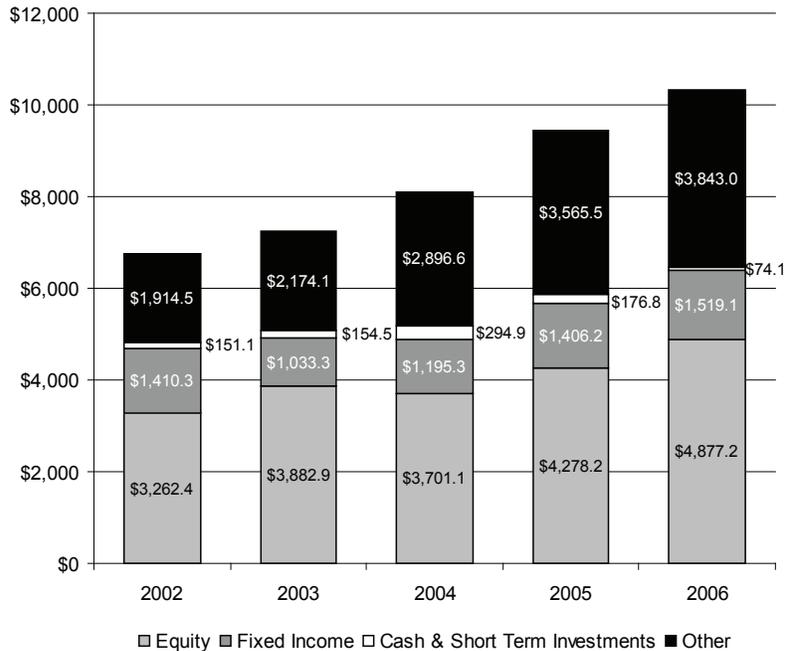


ANNUAL TOTAL RATES OF RETURN FISCAL YEARS 2002 TO 2006



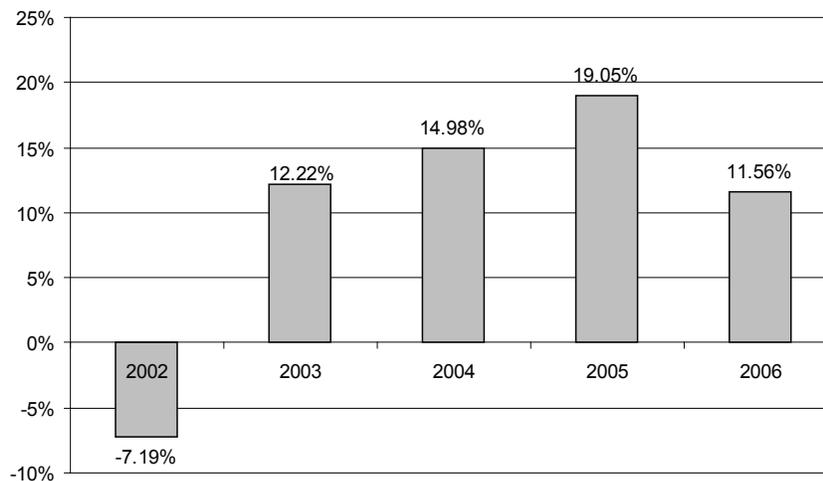
THE UNIVERSITY OF TEXAS SYSTEM— PERMANENT UNIVERSITY FUND

PORTFOLIO DIVERSIFICATION ENDING MARKET VALUES FISCAL YEARS 2002 TO 2006



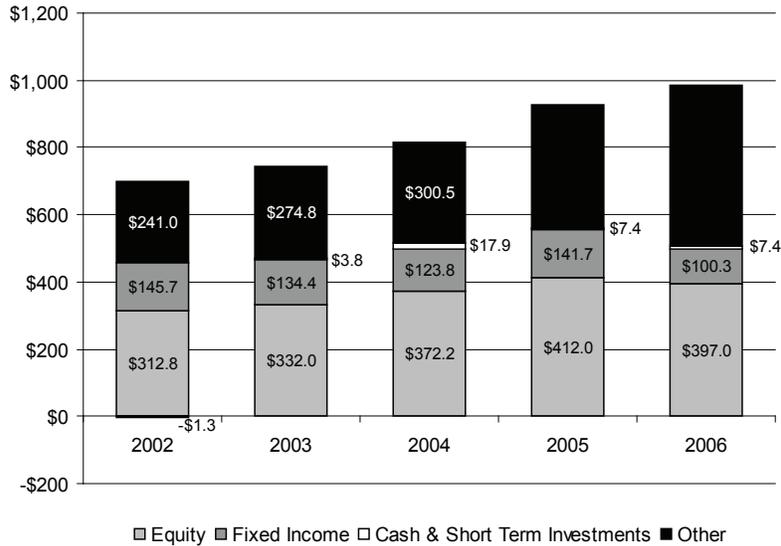
NOTES: Other investments include: directional and absolute return hedge funds, real estate investment trusts, private market investment funds, and commodities.
The UT-PUF prior year balances have been restated to reflect changes in targets for their asset mix.

ANNUAL TOTAL RATES OF RETURN FISCAL YEARS 2002 TO 2006



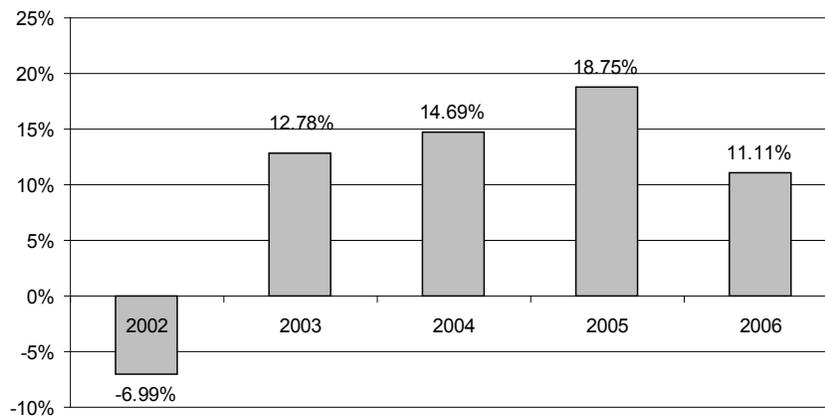
THE UNIVERSITY OF TEXAS SYSTEM— PERMANENT HEALTH FUND

PORTFOLIO DIVERSIFICATION ENDING MARKET VALUES FISCAL YEARS 2002 TO 2006



NOTES: The PHF assets are invested in the UT System General Endowment Fund (GEF). The allocation of PHF ending market value is based upon the allocation of GEF ending market value. The Permanent Fund Higher Education Nursing, Allied Health, the Permanent Fund for Minority and Research Education, and other health-related programs were transferred from the University of Texas System to the Comptroller of Public Accounts during fiscal year 2002. Other investments include: directional and absolute return hedge funds, real estate investment trusts, private market investment funds, and commodities.

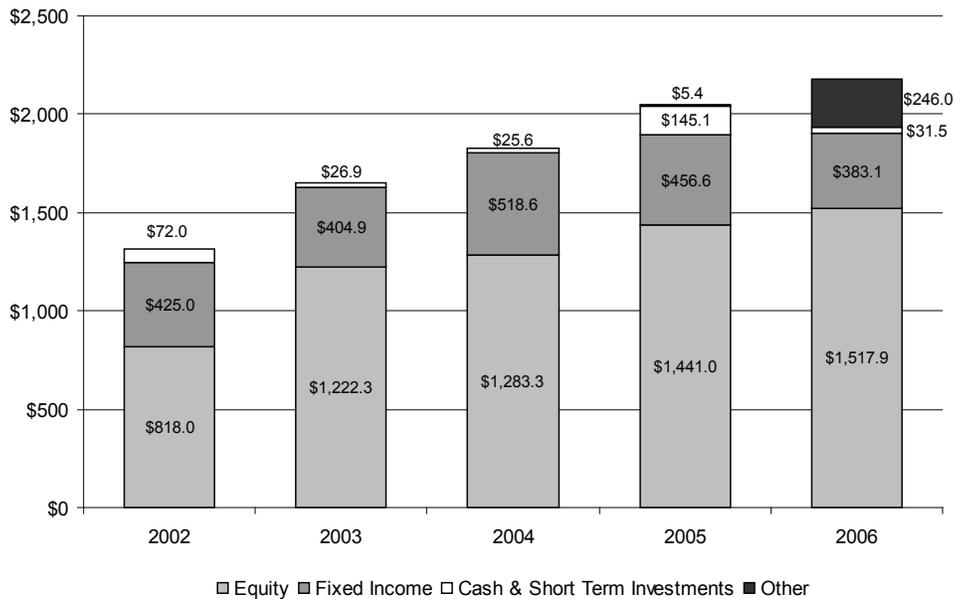
ANNUAL TOTAL RATES OF RETURN FISCAL YEARS 2002 TO 2006



NOTE: The Permanent Health Fund was created by the Seventy-sixth Legislature, 1999; initial contribution was made on August 31, 1999. It was consolidated with the Long-Term Fund on March 1, 2001. The rates for fiscal years 2001 to the present reflect the rates for the consolidated funds.

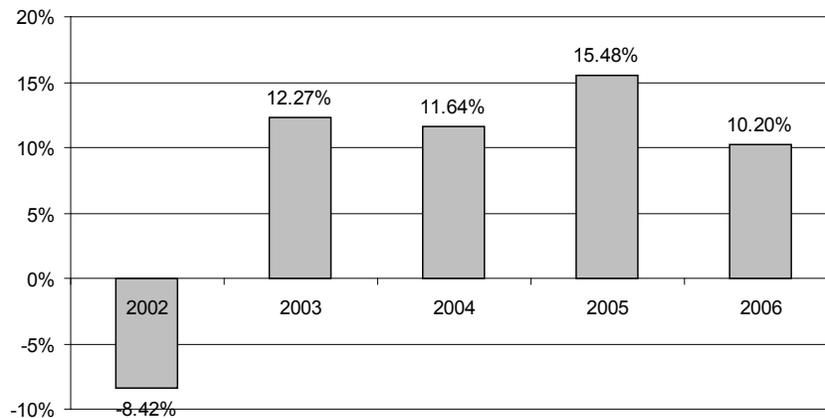
COMPTROLLER OF PUBLIC ACCOUNTS— TOBACCO SETTLEMENT PERMANENT TRUST FUND

PORTFOLIO DIVERSIFICATION ENDING MARKET VALUES FISCAL YEARS 2002 TO 2006



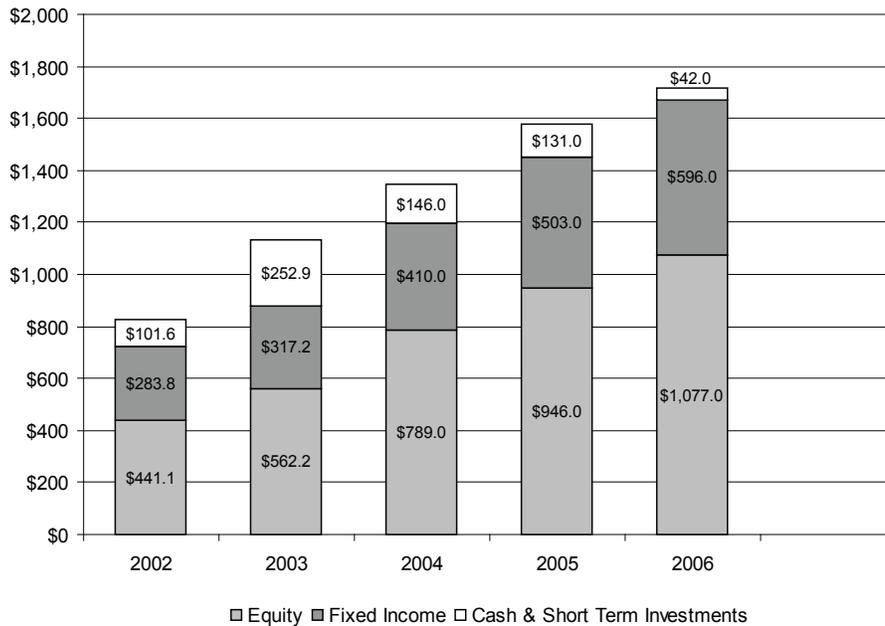
NOTES: The Tobacco Settlement Permanent Trust Fund was created by the Seventy-sixth Legislature, 1999; initial contribution was made on December 30, 1999. Other investments include: directional and non-directional hedge funds, private equity, and real estate.

ANNUAL TOTAL RATES OF RETURN FISCAL YEARS 2002 TO 2006



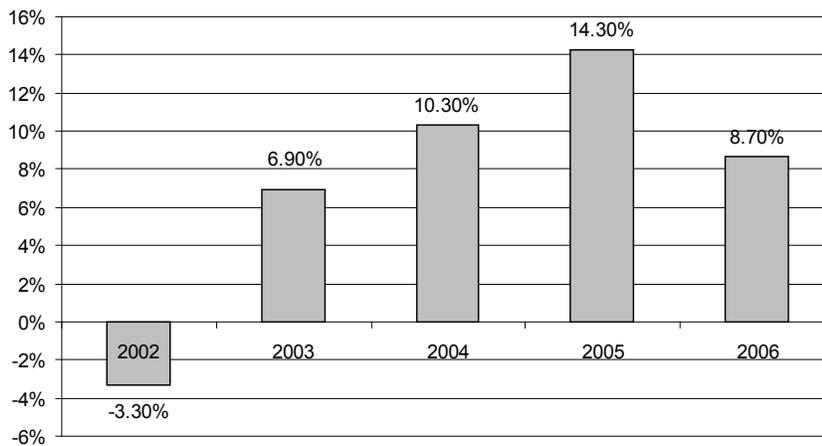
COMPTROLLER OF PUBLIC ACCOUNTS— TEXAS GUARANTEED TUITION PLAN FUND

**PORTFOLIO DIVERSIFICATION
ENDING MARKET VALUES
FISCAL YEARS 2002 TO 2006**



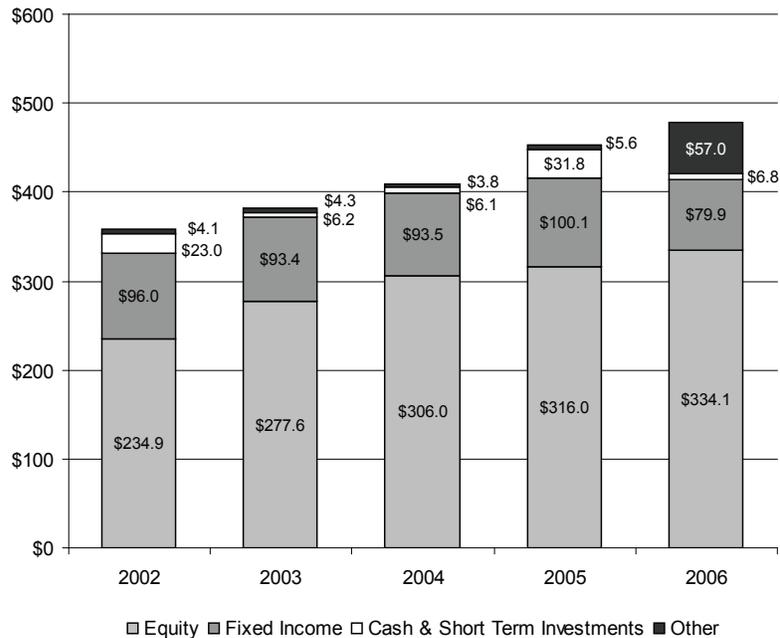
NOTE: The other investments category is not applicable to this fund. See Attachment 7.

**ANNUAL TOTAL RATES OF RETURN
FISCAL YEARS 2002 TO 2006**



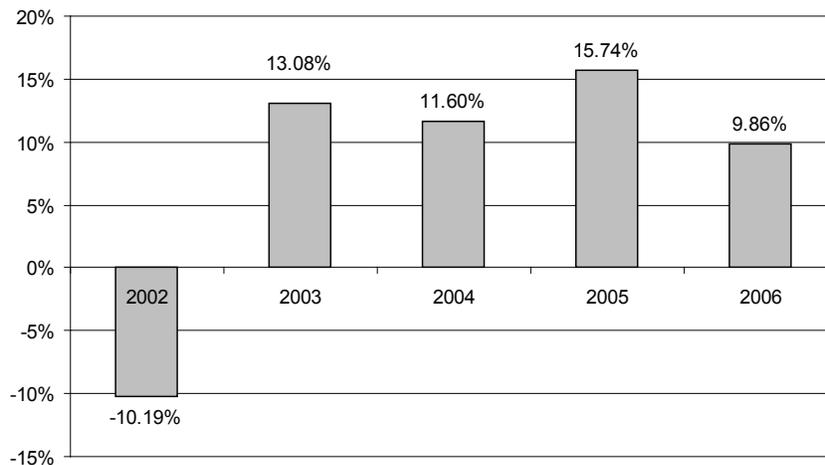
COMPTROLLER OF PUBLIC ACCOUNTS— PERMANENT PUBLIC HEALTH FUND

PORTFOLIO DIVERSIFICATION ENDING MARKET VALUES FISCAL YEARS 2002 TO 2006



NOTES: The Permanent Public Health Fund was created by the Seventy-sixth Legislature, 1999; initial contribution was made on August 31, 1999. Other investments include: directional and non-directional hedge funds, private equity, and real estate.

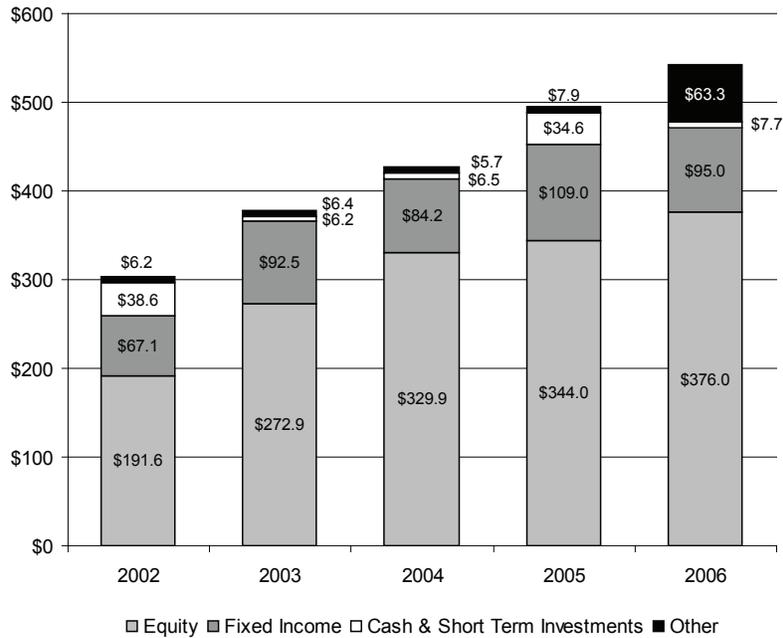
ANNUAL TOTAL RATES OF RETURN FISCAL YEARS 2002 TO 2006



NOTES: The Permanent Public Health Fund was created by the Seventy-sixth Legislature, 1999; initial contribution was made on August 31, 1999.

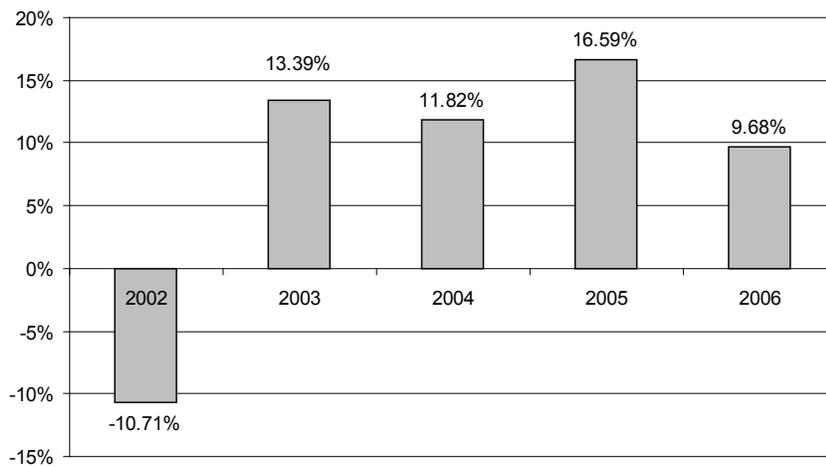
COMPTROLLER OF PUBLIC ACCOUNTS— PERMANENT HIGHER EDUCATION FUND

**PORTFOLIO DIVERSIFICATION
ENDING MARKET VALUES
FISCAL YEARS 2002 TO 2006**



NOTE: Other investments include: directional and non-directional hedge funds, private equity, and real estate.

**ANNUAL TOTAL RATES OF RETURN
FISCAL YEARS 2002 TO 2006**



APPENDIX A. AUTHORIZING STATUTE

SECTION 1. Chapter 322, Government Code, is amended by adding Section 322.014 to read as follows:

Sec. 322.014. REPORT ON MAJOR INVESTMENT FUNDS.

- (a) In this section, “state investment fund” means any investment fund administered by or under a contract with any state governmental entity, including a fund:
 - (1) established by statute or by the Texas Constitution; or
 - (2) administered by or under a contract with:
 - (A) a public retirement system as defined by Section 802.001, Government Code, that provides service retirement, disability retirement, or death benefits for officers or employees of the state;
 - (B) an institution of higher education as defined by Section 61.003, Education Code; or
 - (C) any other entity that is part of state government.
- (b) The board shall evaluate and publish an annual report on the risk-adjusted performance of each state investment fund that in the opinion of the board contains a relatively large amount of assets belonging to or administered by the state. The board in its report shall:
 - (1) compare the risk-adjusted performance of the funds; and
 - (2) examine the risk-adjusted performance, within and among the funds, of similar asset classes and comparable portfolios within asset classes.
- (c) Each state governmental entity that administers a state investment fund and each person that administers a state investment fund under contract shall provide the board with the information the board requests regarding the performance of the fund.
- (d) The board shall publish the annual report in a format and using terminology that a person without technical investment expertise can understand.

APPENDIX B. MAJOR STATE INVESTMENT FUNDS

TEACHER RETIREMENT SYSTEM—PENSION TRUST FUND

FUND PURPOSE

The Teacher Retirement System of Texas (TRS) administers a defined benefit plan that is a qualified pension trust fund under Section 401(a) of the Internal Revenue Code. The pension trust fund provides service and disability retirement, as well as death and survivor benefits, to eligible employees of public education in Texas and their beneficiaries.

FUND CONTRIBUTIONS

Member contributions, state contributions, reporting entity contributions, member reinstatements, and investment income increase the fund. The state constitution requires the legislature to establish a member contribution rate of not less than 6 percent of the member's annual compensation and a state contribution rate of not less than 6 percent and not more than 10 percent of the aggregate annual compensation of all members of the system during that fiscal year. The contribution rates for fiscal year 2006 remained the same as fiscal year 2005 with the members contributing 6.4 percent and the state contributing 6.0 percent.

The system's Comprehensive Annual Financial Report for fiscal year 2006 reflects member contributions were \$1.7 billion, state contributions were \$1.3 billion, reporting entity contributions were \$267.4 million, member reinstatements were \$154.6 million, and net investment income was \$9.0 billion.

FUND DISTRIBUTIONS

Deductions from the fund are predominantly retirement, death, and survivor benefits. During fiscal year 2006 the fund paid \$5.6 billion for benefits, \$265.5 million for members refunding their accounts, and \$27.5 million for administrative expenses (net of investing activity expenses).

INVESTMENT OBJECTIVE

The board governs the investment process by adopting investment policies and objectives, which define the fund's strategic investment initiatives, and by monitoring performance to measure the results of both tactical and strategic investment strategies. The total investment portfolio is structured to achieve a long-term rate of return that exceeds the assumed actuarial rate of return adopted by the board; exceeds the long-term rate of inflation by an annualized 3 percent; and exceeds a composite index composed of the

respective long-term normal asset mix weighting of the major asset classes, operating within the defined risk parameters for the various asset classes. Investment decisions must adhere to the "prudent person" rule.

INVESTMENT AND OVERSIGHT RESPONSIBILITY

The TRS Board of Trustees holds system assets in trust and oversees the investment of the system's funds in accordance with applicable constitutional and statutory provisions. The board is composed of nine trustees who are appointed by the governor to staggered terms of six years. Three trustees are direct appointments. Two trustees are appointed from a list prepared by the State Board of Education. Two trustees are appointed by the governor from the three public school district active member candidates nominated for each position by employees of public school districts. One trustee is appointed from the three higher education active member candidates nominated by employees of institutions of higher education. One trustee is appointed from the three retired member candidates nominated by retired TRS members. A majority of the board is required to have financial expertise. Appointments are subject to confirmation by the Senate. Board member terms expire August 31st of odd numbered years.

PERCENTAGE OF ASSETS EXTERNALLY MANAGED/ ADVISED

According to TRS, internal staff manages all TRS assets. The board has not delegated any discretionary investment authority to external investment management firms.

INVESTMENT COSTS

The cost of investing the funds for fiscal year was \$19.0 million, or 2 basis points (0.02%) of the net assets held in trust for pension benefits at the end of fiscal year 2006. The investment cost consists of \$13.2 million in direct internal cost and \$5.9 million in indirect internal cost. According to TRS, investment expenses included items such as salaries and other personnel costs, dues, fees and staff development, travel, subscriptions and reference materials, consumable supplies, professional fees and services, furniture, equipment and maintenance. Prior year investment costs were \$17.4 million or 0.02 percent of the net asset held in trust for pension benefits at the end of the year.

TEACHER RETIREMENT SYSTEM—PENSION TRUST FUND (CONTINUED)

PERFORMANCE BENCHMARKS

The following benchmarks were provided by TRS. The benchmark shown in italics has been updated from fiscal year 2005.

- *Fixed Income – 93 percent Lehman Brothers Aggregate Bond Index and 7 percent Citigroup High Yield Index through March 2006; and currently, Lehman Brothers Universal.*
- Domestic Large Cap Equities – Standard & Poor's 500 Index
- Domestic Mid Cap Equities – Standard & Poor's Mid Cap 400 Index
- Domestic Small Cap Equities – Standard & Poor's Small Cap 600 Index
- International Equities – Morgan Stanley Capital International (MSCI) All Country World Index ex-U.S.
- Private Equities -Three years at zero, then Russell 2000 plus 500 basis points
- Absolute Return – 70 percent three-month London InterBank Offered Rate (LIBOR) plus 30 percent Standard & Poor's 500 Index
- Real Estate – NCREIF Property Index

RECENT LEGISLATION

The Seventy-ninth Legislature, Regular Session, 2005, enacted several bills that affect TRS. The most significant is Senate Bill 1691. The bill makes numerous changes affecting TRS policies and operations. Changes affecting the pension fund include the addition of a minimum age of 60 to the Rule of 80 for purposes of determining eligibility for a TRS service retirement. The legislation includes a grandfathering clause that allows individuals who establish TRS membership prior to September 1, 2007, to retire under the eligibility rules in effect prior to the effective date of the legislation. Senate Bill 1691 also requires school districts that hire TRS retirees to work in TRS-covered positions to contribute an amount equivalent to the state and the active member contribution to the pension fund (currently 6 percent for the state contribution plus 6.4 percent for the active member

contribution). In addition, for retirees enrolled in the TRSCare group health insurance program, school districts are required to pay the difference between the retiree's cost and the total cost of coverage under the plan for retirees working in TRS-covered positions. These changes to the return-to-work program apply only to retirees who were not reported as retirees employed by a district as of January 2005.

Senate Bill 1691 contains several provisions addressing other TRS policy issues, including the elimination of subsidized early retirement, changes in eligibility to participate in TRSCare, changes in eligibility for the Partial Lump Sum Option, discontinuation for new participation in the Deferred Retirement Option Plan at the end of calendar year 2005, a change in the calculation of final average salary for determining annuity amounts to include the highest five years of salary (instead of three years), and changes to policies regarding service credit purchases. After January 1, 2006, TRS members were no longer permitted to purchase service credit, also referred to as air time. Out-of-state service credit purchases require actuarially equivalent contributions after January 1, 2006, with some exceptions.

Senate Bill 1691 also makes several changes to policies regarding TRS administration and requirements regarding administrative interactions with other state agencies. Under legislation enacted by the Seventy-eighth Legislature, Regular Session, 2003, a 90-day waiting period for new employees was created, during which time neither TRS-Care nor TRS retirement contributions are required. That provision was allowed to expire as of August 31, 2005. Senate Bill 1691, Seventy-ninth Legislature, Regular Session, 2005, requires that employers make a 6 percent contribution to the pension fund in lieu of a state contribution during the first 90 days of employment for a new employee. School district and active member contributions to TRS-Care apply from the first day of employment.

PERMANENT SCHOOL FUND

FUND PURPOSE

The Permanent School Fund (PSF) was created expressly for the benefit of funding Texas public schools. A total return distribution, which is currently 4.5 percent of average market value, along with 25 percent of the state's motor fuel tax revenues are transferred to the Available School Fund (ASF). Monies from the fund are distributed to local public school districts based on the average daily attendance of public school students.

FUND CONTRIBUTIONS

Proceeds from the sale of PSF land, royalty, and other earnings generated by the PSF land are added annually to the fund by the General Land Office (GLO), which manages the real estate assets. According to the Texas Education Agency (TEA), \$121.7 million was added to the PSF during fiscal year 2006.

FUND DISTRIBUTIONS

The Fund calculates its annual distribution to the Available School Fund (ASF) using a total return methodology, established by Constitutional amendment in 2003. Distribution rates are set by a two-thirds (2/3) vote of the State Board of Education (SBOE). If the SBOE does not set the rate prior to the start of the next Legislative session, then the Legislature will set the distribution rate. The distribution rate cannot exceed 6.0 percent and the total distribution over the past ten years cannot exceed the total return for the same period. The SBOE set the distribution rate at 4.5 percent for fiscal years 2006 and 2007. In fiscal year 2006, \$841.9 million was distributed to the ASF.

INVESTMENT OBJECTIVE

The investment objective, according to TEA, is long term and focused on fairly balancing the benefits between current and future generations while preserving the real per capita value of the PSF. Investment decisions adhere to the "prudent person" rule and asset class allocations are adjusted accordingly to meet the investment objectives of the Fund.

INVESTMENT AND OVERSIGHT RESPONSIBILITY

The Texas Constitution assigns control of PSF assets to the SBOE while administrative duties related to the PSF reside with the Commissioner of Education and TEA staff. SBOE

members are elected from 15 single-member districts with the governor designating the chairman. No members are required to have experience in investment management. The SBOE appoints a Committee of Investment Advisors ("CIA") to provide independent review of the Fund's investment policies, procedures, and nature of investments. Each member of the SBOE appoints a single member to the CIA, and these advisors serve at the pleasure of the SBOE member that appointed them.

PERCENTAGE OF ASSETS EXTERNALLY MANAGED/ ADVISED

According to TEA, approximately 19.65 percent of PSF assets are externally managed. Independent firms are used to invest funds, provide custodial and accounting services, provide securities lending services, advise on asset allocation, and evaluate investment performance.

INVESTMENT COSTS

According to TEA, the cost of administering the fund was \$5.4 million or 0.02 percent of the ending fund balance for fiscal year 2006. This includes \$4.7 million in internal direct costs and \$700,000 in fees paid to external entities. In addition to standard investment salaries, costs and allocated agency overhead, TEA reports investment expenses included costs associated with accounting, information technology, compliance and support staff; as well as services provided by the State Office of Risk Management (SORM) and the State Wide Cost Allocation Plan (SWCAP). Prior year investment costs were \$7.1 million or 0.03 percent of the ending fund balance.

PERFORMANCE BENCHMARKS

The following benchmarks were provided by TEA.

- Fixed Income, managed internally – Lehman Brothers Aggregate Bond Index
- Domestic Large Cap Equities, Passive – Standard & Poor's 500 Stock Composite Index
- Domestic MidCap and Small Cap Equities, Passive – Standard & Poor's 1000 Stock Composite Index
- International Equities, Passive – Morgan Stanley Capital International World Ex-U.S. Net Dividends

PERMANENT SCHOOL FUND (CONTINUED)

An allocation index is calculated for each class of investments (fixed income and equity securities) to measure the overall performance. The allocation index is the weighted average rate of return of each of the above indices.

RECENT LEGISLATION

House Bill 2217, passed by the Seventy-ninth Legislature, 2005, added a cap of 15 percent to the portion of the PSF that may be invested in real estate.

EMPLOYEES RETIREMENT SYSTEM—PENSION TRUST FUND

FUND PURPOSE

The Employees Retirement System of Texas was created by the Texas Legislature in 1947 and is administered in accordance with the Texas Constitution. The System provides a retirement and disability pension plan for State employees, law enforcement and custodial officers, elected state officials and two classes of judges. The system administers the trust funds with a fiduciary obligation to the members and retirees of the System who are its beneficiaries. The Employees Retirement System of Texas Plan (ERS), the Law Enforcement and Custodial Officer Supplemental Retirement Plan (LECOS), the Judicial Retirement System of Texas Plan One (JRSI), and the Judicial Retirement System of Texas Plan II (JRS II) are single employer defined benefit pension plans. For investment purposes the trust funds are commingled but separate accounting records are maintained.

FUND CONTRIBUTIONS

Member and state contributions are made to the trust funds as a percent of compensation set by state law. For ERS the constitution provides that the state contribution may not be less than 6 percent nor more than 10 percent and the member contribution may not be less than 6 percent. For 2006–07, the member contribution was 6 percent and the state contribution was 6.45 percent. No contributions from either the state or the members have been made to the LECOS fund since 1993. JRS I is a pay as you go plan and there is no trust fund to receive contributions. Member contributions of 6 percent go to the general revenue fund. Contributions to JRS II are set by general law and the state appropriations act. For 2006–07, the member contribution was 6.45 percent and the state contribution was 16.83 percent. According to ERS, total member contributions to the pension trust funds for fiscal year 2006 were \$333.5 million and the total state contributions were \$326.2 million. In fiscal year 2005 total member contributions to the pension trust funds were \$308.9 million and the total state contributions were \$284.4 million.

FUND DISTRIBUTIONS

Distributions from the pension trust fund are based on benefit payments owed, and according to ERS, equaled \$1.3 billion in fiscal year 2006.

INVESTMENT OBJECTIVE

The primary investment objective, according to ERS, is to earn a return that will insure the payments due to members of the retirement plans and their beneficiaries are at a reasonable cost to the members and the taxpayers of the state. Investment decisions must adhere to the duty of care as set forth in Sec. 815.307 of the Government Code.

INVESTMENT AND OVERSIGHT RESPONSIBILITY

The Board of Trustees of ERS has general responsibility for investment decisions. Six members serve on the board: three members are elected by participating state employees, one member is appointed by the governor, one is appointed by the chief justice of the Supreme Court, and one member is appointed by the speaker of the House of Representatives. The board appoints an investment advisory committee. The committee members are investment professionals who are required to meet at least quarterly to review ERS investments.

PERCENTAGE OF ASSETS EXTERNALLY MANAGED/ ADVISED:

According to ERS, approximately 64.4 percent of the agency's invested funds are handled completely by internal staff. For the remaining 35.6 percent, staff receives counsel from various fund advisors.

INVESTMENT COSTS

According to ERS, the cost of investing the funds was \$19.0 million or 0.1 percent of the ending fund balance for fiscal year 2006. This includes \$3.5 million in direct internal expenses, \$1.6 million in indirect internal investment expenses, and \$13.8 million in external investment expenses. Investment expenses included costs related to technology, compliance, support staff, operations and investment custodians. Prior year investment costs were \$16.2 million or 0.08 percent of the ending fund balance.

PERFORMANCE BENCHMARKS

The following benchmarks were provided by ERS.

- Fixed Income – Investment Grade - Lehman Brothers Aggregate Bond Index

EMPLOYEES RETIREMENT SYSTEM—PENSION TRUST FUND (CONTINUED)

- Domestic Large Cap Equities – Standard & Poor’s 500 Stock Composite Index
- International Equities – Europe, Australia and Far East (EAFE) Index
- Cash Equivalents – 91-day U.S. Treasury Bill rate

RECENT LEGISLATION

Senate Bill 11, enacted by the Seventy-ninth Legislature, Regular Session, 2005, increased the state-paid ERS contribution rate for the 2006–07 biennium from 6 percent to 6.45 percent of the employee’s salary. The contribution rate covers the normal cost of paying annuity benefits as reported in the ERS actuarial valuation report dated February 28, 2005.

Senate Bill 1176, enacted by the Seventy-ninth Legislature, Regular Session, 2005, makes permanent the 90-day wait for ERS retirement membership for newly-hired employees. Payroll deductions for the 6.45 percent contributed by the state and the 6 percent contributed by the employee begin following the 90-day wait.

The bill provides for a reduction for the standard non-occupational disability retirement annuity. The reduction is based on actuarial tables adopted by the board of trustees and applies to members who retire before reaching the normal age and length of time for retirement eligibility. The bill also makes the death benefit plan available only to active state employees and for members who filed a death plan prior to September 1, 2005.

Senate Bill 1176 increases interest charges on payments to reestablish service from 5 percent to 10 percent (effective 9/1/06). The bill restricts the purchase of additional service credit to 36 months (effective 1/1/06) and it eliminates use of other governmental service toward retirement eligibility if not established by January 1, 2006.

Senate Bill 1863, enacted by the Seventy-ninth Legislature, Regular Session, 2005, increased the longevity pay and hazardous duty pay for state employees and employees of institutions of higher education effective September 1, 2005. Currently longevity pay is \$20 per month for every 3 years of service. The bill increased this to \$20 per month for every 2 years of service. Currently hazardous duty pay is \$7 per

month for every year of service. The bill increased this amount to \$10 per month for every year of service.

Senate Bill 262, enacted by the Seventy-ninth Legislature, Regular Session, 2005, removes Texas State Board of Pharmacy law enforcement officers commissioned on or after August 31, 2005, from eligibility to receive the supplemental retirement benefits. As of August 31, 2005, there were 45,679 members of the fund and 5,072 retired annuitants receiving supplemental benefits.

House Bill 70, enacted by the Seventy-ninth Legislature, Regular Session, 2005, requires ERS to provide payment of the lump-sum death benefit not later than the seventh day after the date the board receives the required proof of death.

House Bill 617, enacted by the Seventy-ninth Legislature, Regular Session, 2005, allows a Judicial Retirement Plan II (JRS II) judge to stop making contributions when the member has served at least twelve years on an appellate court and reached a “rule of 70.”

House Bill 831, enacted by the Seventy-ninth Legislature, Regular Session, 2005, changed the official retirement qualifications of appellate judges from two full terms to twelve years served.

House Bill 1079, enacted by the Seventy-ninth Legislature, Regular Session, 2005, changed the service retirement eligibility requirements for JRS II to allow retirement with least 20 years of service at any age.

House Bill 1114, enacted by the Seventy-ninth Legislature, Regular Session, 2005, increased benefits for members of JRS II.

House Bill 11, Seventy-ninth Legislature, Second Called Session, 2005, authorizes pay increases of 23 percent for district judges, with a maximum increase of 33 percent for appellate judges. The pay increase includes active members of JRS I and JRS II and all annuitants under the new salary schedule.

UNIVERSITY OF TEXAS SYSTEM—PERMANENT UNIVERSITY FUND

FUND PURPOSE

The Permanent University Fund (PUF) is a public endowment contributing to the support of most institutions in the University of Texas System (UT System) and the Texas A&M University System. Distributions from the PUF as well as all surface lease income are deposited in the Available University Fund (AUF) for the benefit of the eligible institutions.

FUND CONTRIBUTIONS

Mineral and other incomes are added annually to the fund. According to the UT System, \$215.0 million in income earned by PUF lands were contributed to the PUF during fiscal year 2006.

FUND DISTRIBUTIONS

The PUF is a total return fund, and amounts from both income as well as changes in asset values may be distributed. The UT System Board has established an annual distribution to the AUF of 4.75 percent of the prior three years average net asset value of the PUF. According to the UT System, \$357.3 million was paid to the AUF in fiscal year 2006.

INVESTMENT OBJECTIVE

According to the UT System, the primary goal is to preserve the purchasing power of the PUF's assets and annual distributions by earning an average annual total return after inflation of 5.1 percent over rolling ten-year periods or longer. The objective is dependent on the ability to generate high returns in periods of low inflation that will offset lower returns generated in years when the capital markets underperform the rate of inflation. Investment decisions must adhere to the "prudent investor" rule.

INVESTMENT AND OVERSIGHT RESPONSIBILITY

The Texas Constitution assigns responsibility for managing the PUF's lands and investment to the UT System Board of Regents. The PUF's investment manager is the University of Texas Investment Management Company (UTIMCO). UTIMCO is the first external management corporation formed by a public university. The UTIMCO Board of Directors includes three members of the UT System Board, the chancellor of the UT System, and five outside investment professionals.

PERCENTAGE OF ASSETS EXTERNALLY MANAGED/ ADVISED

According to the UT System, approximately 75.02 percent of the PUF assets are externally managed.

INVESTMENT COSTS

According to the UT System, total investment expenses were \$82.6 million or 0.8 percent of the ending fund balance. This amount includes \$2.5 million for direct internal costs, \$3.1 million for indirect internal costs, and \$77.0 million for external costs for fiscal year 2006. The investment expenses included costs for management fees and fees related to custodial, auditing, consulting, performance, risk management, and securities lending services. Investment costs for the previous fiscal year were \$51.0 million or 0.54 percent of the ending fund balance.

PERFORMANCE BENCHMARKS

The Endowment Policy Portfolio return is the total index or benchmark return for the PUF. This return is the sum of the weighted benchmark return for each asset class comprising the endowment policy portfolio.

The UT System provided the following benchmark returns for each asset class. The benchmarks shown in italics have been updated from fiscal year 2005.

- Fixed Income – Lehman Brothers Aggregate Bond Index
- U.S. Equities – Russell 3000 Index
- *Global ex U.S. Equities – Morgan Stanley Capital International – Europe, Australia and Far East (EAFE) Index with net dividends*
- *Emerging Markets – Morgan Stanley Capital International – Emerging Markets Index with net dividends*
- *Hedge Fund – Directional – 50 percent Standard & Poor's Event Driven Hedge Fund Index and 50 percent Standard & Poor's Directional/Tactical Hedge Fund Index through December 2005; and currently Morgan Stanley Capital International Investable Hedge Fund Index.*
- *Hedge Fund – Absolute Return – 67 percent Standard & Poor's Event Driven Hedge Fund Index and 33 percent*

UNIVERSITY OF TEXAS SYSTEM—PERMANENT UNIVERSITY FUND (CONTINUED)

Standard & Poor's Arbitrage Hedge Fund Index through December 2005; and currently Morgan Stanley Capital International Investable Hedge Fund Index.

- *Real Estate – Dow Jones Wilshire Real Estate Securities Index*
- *Commodities – 67 percent Goldman Sachs Commodities Index minus 50 basis points and 33 percent Dow Jones AIG Commodity Index*
- *Treasury Inflation-Protected Securities (TIPS) – Lehman Brothers U.S. TIPS Index*
- *Private Capital – Venture Economics' Periodic IRR Index*
- *Cash and Equivalents – 90-Day T-Bill Average Yield*

UNIVERSITY OF TEXAS SYSTEM—PERMANENT HEALTH FUND

FUND PURPOSE

The Permanent Health Fund (PHF) is a collection of public endowments to support research and other programs at higher education institutions. The consolidated fund includes the Permanent Health Fund for Higher Education, Permanent Funds for Health-related Institutions, and the University of Texas at El Paso. The Permanent Fund for Higher Education Nursing, Allied Health and Other Health Related Programs, and the Permanent Fund for Minority Health Research and Education were transferred to the Comptroller of Public Accounts (CPA) during fiscal year 2002. The endowments were created with proceeds from the comprehensive tobacco settlement between the State and the tobacco industry.

FUND CONTRIBUTIONS

Initially \$890 million of endowment corpus was transferred on August 30, 1999, and another \$25 million was transferred during fiscal year 2000. The Permanent Fund for Higher Education Nursing, Allied Health and Other Health Related Programs, and the Permanent Fund for Minority Health Research and Education, totaling \$88.2 million, were transferred to the CPA during fiscal year 2002. No contributions were made in fiscal years 2003, 2004, 2005 or 2006.

FUND DISTRIBUTIONS

The PHF is a total return fund, and distributions from both income as well as capital gains may be distributed. The University of Texas (UT) System Board initially established an annual distribution of 4.5 percent of the beginning value of the PHF. Distributions are increased annually by the average inflation rate Consumer Price Index (C.P.I.) provided that the distribution rate remains within a range of 3.5 percent to 5.5 percent of the fund's market value. According to the UT System, \$39.5 million was transferred to eligible institutions during fiscal year 2006.

INVESTMENT OBJECTIVE

According to the UT System, the primary goal is to preserve the purchasing power of the PHF assets and annual distributions by earning an average annual real return of 5.1 percent over rolling ten-year periods or longer.

INVESTMENT AND OVERSIGHT RESPONSIBILITY

The Seventy-sixth Legislature, 1999, designated the UT System Board of Regents as the administrators of the fund. The UT System Board of Regents designated the University of Texas Investment Management Company (UTIMCO) as the investment manager. UTIMCO is the first external management corporation formed by a public university. The UTIMCO Board of Directors includes three members of the UT System Board, the chancellor of the UT System, and five outside investment professionals. The Long Term Fund (LTF) and the PHF are invested in shares of the General Endowment Fund (GEF), an internal mutual fund managed by UTIMCO.

PERCENTAGE OF ASSETS EXTERNALLY MANAGED/ ADVISED

The PHF assets are invested in the UT System GEF. According to the UT System, approximately 75 percent of the GEF assets are externally managed.

INVESTMENT COSTS

According to the UT System, total investment expenses for fiscal year 2006 were \$3.8 million or 0.4 percent of the ending fund balance. This amount includes \$0.3 million in direct investment expenses, \$0.4 million in indirect investment expenses, and \$3.1 million in external expenses. The investment expenses included costs for management fees and fees related to custodial, auditing, consulting, performance, risk management, and securities lending services. Investment costs for fiscal year 2005 were \$5.0 million or 0.54 percent of the ending fund balance.

PERFORMANCE BENCHMARKS

The PHF assets are invested in the GEF. The Endowment Policy Portfolio return is the total index or benchmark return for the GEF. This return is the sum of the weighted benchmark return for each asset class comprising the endowment policy portfolio.

The UT System provided the following benchmark returns for each asset class. The benchmarks shown in italics have been updated from fiscal year 2005.

- Fixed Income – Lehman Brothers Aggregate Bond Index

UNIVERSITY OF TEXAS SYSTEM—PERMANENT HEALTH FUND (CONTINUED)

- Absolute Return – 90 Day T-Bills Average Yield Plus 3 Percent.
- U.S. Equities – Russell 3000 Index
- *Global ex U.S. Equities – Morgan Stanley Capital International – Europe, Australia and Far East (EAFE) Index with net dividends*
- *Emerging Markets – Morgan Stanley Capital International – Emerging Markets Index with net dividends*
- *Hedge Fund – Directional – 50 percent Standard & Poor's Event Driven Hedge Fund Index and 50 percent Standard & Poor's Directional/Tactical Hedge Fund Index through December 2005; and currently Morgan Stanley Capital International Investable Hedge Fund Index.*
- *Hedge Fund – Absolute Return – 67 percent Standard & Poor's Event Driven Hedge Fund Index and 33 percent Standard & Poor's Arbitrage Hedge Fund Index through December 2005; and currently Morgan Stanley Capital International Investable Hedge Fund Index.*
- *Real Estate – Dow Jones Wilshire Real Estate Securities Index*
- *Commodities – 67 percent Goldman Sachs Commodities Index minus 50 basis points and 33 percent Dow Jones AIG Commodity Index*
- *Treasury Inflation-Protected Securities (TIPS) – Lehman Brothers U.S. TIPS Index*
- Private Capital – Venture Economics' Periodic IRR Index
- Cash and Equivalents – 90-Day T-Bill Average Yield

COMPTROLLER OF PUBLIC ACCOUNTS—TOBACCO SETTLEMENT PERMANENT TRUST FUND

FUND PURPOSE

The Tobacco Settlement Permanent Trust (TSF) is an endowment to support counties with unreimbursed healthcare expenditures. The Seventy-sixth Legislature, 1999, created the endowment with proceeds from the comprehensive tobacco settlement between the State and the tobacco industry. Although the Comptroller of Public Accounts (CPA) manages the investments, the endowment is classified as a private purpose trust fund.

FUND CONTRIBUTIONS

The initial contribution of tobacco settlement proceeds was made on March 1, 2000. According to the CPA, \$1.683 billion were contributed to the fund through fiscal year 2003. No additional contributions are anticipated.

FUND DISTRIBUTIONS

The TSF is a total return fund and distributions may be made from both income as well as growth in asset values. The investment advisory committee (described below) has approved, and the CPA has adopted, a distribution rule set forth in Title 34, Part 1, Chapter 18, Section 18.2 of the Texas Administrative Code. The rule is designed to meet the investment objective of the trust (described below). According to the CPA, \$72.0 million was distributed during fiscal year 2006.

INVESTMENT OBJECTIVE

The primary investment objective, according to the CPA, is to provide a predictable, stable stream of distributions and to preserve the purchasing power of fund assets and annual distributions by earning an average annual total return after inflation of 5.0 percent over rolling ten-year periods or longer. Investment decisions must adhere to the “prudent investor” rule.

INVESTMENT AND OVERSIGHT RESPONSIBILITY

The CPA, through the Texas Treasury Safekeeping Trust Company, is responsible for management and oversight of the fund. An investment advisory committee composed of members from participating entities advises the CPA and approves rules governing the CPA’s duties and responsibilities for the investment of and distributions from the fund. The Seventy-eighth Legislature, 2003, amended the method for

appointing some of members of the advisory committee. The advisory committee is composed of 11 appointed members. The comptroller appoints one member. One member is appointed by the political subdivision that, in the year preceding the appointment, received the largest annual distribution paid from the account. The political subdivision that received the second largest annual distribution paid from the account appoints one member. Four members are appointed by the Texas Conference of Urban Counties from subdivisions that received the third through the twelfth largest annual distributions in the preceding year. The County Judges and Commissioners Association of Texas, the North and East Texas County Judges and Commissioners Association, the South Texas County Judges and Commissioners Association, and the West Texas County Judges and Commissioners Association each appoint one member.

PERCENTAGE OF ASSETS EXTERNALLY MANAGED/ ADVISED

Internal staff manages investment grade fixed-income investments and external managers manage equity, high-yield fixed-income, hedge fund, private equity, and real estate investments. According to the CPA, approximately 96.0 percent of the fund’s assets are externally managed.

INVESTMENT COSTS

According to the CPA, total investment expenses for fiscal year 2006 were \$6.4 million or 0.3 percent of the ending fund balance. This amount includes \$2.4 for direct internal costs and \$4.0 million for external costs. Investment expenses included costs for consulting and auditing services, IT systems, compliance monitoring, overhead, risk management services, reporting and investment accounting and management services. The investment costs for fiscal year 2005 were \$3.7 million or 0.2 percent of the ending fund balance.

PERFORMANCE BENCHMARKS

The CPA provided the following benchmarks. The benchmarks shown in italics have been updated from fiscal year 2005.

- Fixed Income – Investment Grade - Lehman Brothers Aggregate Bond Index

COMPTROLLER OF PUBLIC ACCOUNTS—TOBACCO SETTLEMENT PERMANENT TRUST FUND (CONTINUED)

- Fixed Income – High Yield – Lehman Brothers High Yield Bond Index
- Domestic Equities –Standard & Poor’s 1500 Stock Composite Index
- International Equities – Morgan Stanley Capital International – Europe, Australia and Far East (EAFE) Index
- *Hedge Fund – Directional – T-Bill Average Yield plus 4 percent and Standard & Poor’s 500 Stock Composite Index*
- *Hedge Fund – Non-Directional – T-Bill Average Yield plus 3 percent and Lehman Brothers Aggregate Bond Index*
- *Private Equity – Standard & Poor’s 500 Stock Composite Index plus 3 percent.*
- *Real Estate – 90 percent National Council of Real Estate Investment Fiduciaries (NCREIF) Property Index and 10 percent NAREIT Property Index*
- Cash Equivalents – 90-day U.S. Treasury Bill rate

COMPTROLLER OF PUBLIC ACCOUNTS—TEXAS GUARANTEED TUITION PLAN FUND

FUND PURPOSE

The Texas Guaranteed Tuition Plan (formerly the Texas Tomorrow Fund) is a fully guaranteed prepaid tuition program, which began in January 1996.

FUND CONTRIBUTIONS

Member contributions are added annually to the fund. According to the CPA, \$102.1 million in tuition contract payments, \$17,600 in fees and other revenue, and \$135.4 million in investment income were added to the fund during fiscal year 2006 a total of \$237.5 million.

FUND DISTRIBUTIONS

According to the CPA, \$75.2 million was distributed to colleges for tuition payments during fiscal year 2006. An additional \$8.1 million was distributed for administrative expenses and \$19.5 million was refunded to contract purchasers.

INVESTMENT OBJECTIVE

According to the CPA, the investment objective is to accumulate sufficient funds to fully meet current and future obligations to fund participants. To meet this goal, the board has developed four general objectives: preserve the purchasing power of the fund by achieving investment earnings in excess of inflation; protect the fund principal from market value erosion; keep return volatility low by employing prudent fund diversification; and invest assets in compliance with the “prudent person” standard.

INVESTMENT AND OVERSIGHT RESPONSIBILITY

The Texas Prepaid Higher Education Tuition Board directs the investment policies that are carried out by investment managers. The board is chaired by the comptroller and includes two members appointed by the governor and four members appointed by the lieutenant governor. At least two of the lieutenant governor’s appointees are from a list of persons recommended by the speaker of the House of Representatives.

PERCENTAGE OF ASSETS EXTERNALLY MANAGED/ ADVISED

According to the CPA, 100.0 percent of the assets were externally managed.

INVESTMENT COSTS

According to the CPA, the costs of investing the fund for fiscal year 2006 were \$6.6 million or 0.4 percent of the ending fund balance. This amount primarily includes external costs. The investment costs for fiscal year 2005 were \$5.7 million or 0.4 percent of the ending fund balance.

PERFORMANCE BENCHMARKS

The CPA provided the following benchmarks for fiscal year 2005.

- Fixed Income – Investment Grade - Lehman Brothers Aggregate Bond Index
- Fixed Income – High Yield – Lehman Brothers High Yield Bond Index
- Fixed Income – Global – Citigroup World Government Bond Index
- Domestic Equities – Large Capitalization – Russell 1000 Index
- Domestic Equities – Small Capitalization – Russell 2000 Index
- International Equities – Citigroup PMI EPAC Index
- Global Balanced – Global Tactical Asset Allocation Fund – Global Securities Markets Index (UBS Custom Index)
- Cash Equivalents – 90-day T-bill rate

COMPTROLLER OF PUBLIC ACCOUNTS—PERMANENT PUBLIC HEALTH FUND

FUND PURPOSE

The Permanent Public Health Fund (PPHF) is a collection of public endowments to support state-administered health-related programs. The consolidated fund includes the Permanent Tobacco Education and Enforcement Fund, the Permanent Children and Public Health Fund, the Permanent EMS and Trauma Care Fund, the Permanent Rural Health Facility Capital Fund, and the Permanent Small Urban Hospitals Funds. The endowments were created with proceeds from the comprehensive tobacco settlement between the State and the tobacco industry.

FUND CONTRIBUTIONS

Initially, \$475 million of tobacco settlement proceeds were contributed in fiscal year 2000. No additional tobacco proceeds have been added to the fund.

FUND DISTRIBUTIONS

The PPHF is a total return fund and distributions may be made from both income as well as growth in asset values. The annual distributions are determined by the Comptroller of Public Accounts (CPA). Annual distributions, payable quarterly, are calculated as 4.5 percent times the twenty-quarter moving-average value of the PPHF as of June 30 for the following fiscal year. The annual distributions may not exceed 7 percent of the average net fair market value of the investment assets of the fund. According to the CPA, \$18.4 million was transferred during fiscal year 2006 to the Texas Department of Health to fund the relevant programs.

INVESTMENT OBJECTIVE

The primary investment objective, according to the CPA, is to provide a predictable, stable stream of distributions and to preserve the purchasing power of each fund's assets and annual distributions by earning an average annual total return after inflation of 5 percent over rolling ten-year periods or longer. Investment decisions must adhere to the "prudent investor" rule.

INVESTMENT AND OVERSIGHT RESPONSIBILITY

The CPA, through the Texas Treasury Safekeeping Trust Company, is responsible for management and oversight of the fund.

PERCENTAGE OF ASSETS EXTERNALLY MANAGED/ ADVISED

Internal staff manages investment grade fixed-income investments and external managers manage equity, high-yield fixed-income, hedge fund, private equity, and real estate investments. According to the CPA, approximately 96.1 percent of the fund assets are externally managed.

INVESTMENT COSTS

According to the CPA, the costs of administering the fund for fiscal year 2006 were \$1.4 million or 0.3 percent of the ending fund balance and mostly include external costs. Investment expenses included costs for consulting, auditing, IT systems, compliance monitoring, overhead, risk management, reporting, investment accounting, and investment management. Investment costs for fiscal year 2005 were \$1.0 million or 0.2 percent of the fund balance.

PERFORMANCE BENCHMARKS

The CPA provided the following benchmarks. The benchmarks shown in italics have been updated from fiscal year 2005.

- Fixed Income – Investment Grade - Lehman Brothers Aggregate Bond Index
- Fixed Income – High Yield - Merrill Lynch High Yield Bond Index
- Domestic Equities – Standard & Poor's 1500 Stock Composite Index
- International Equities – Europe, Australia and Far East (EAFE) Index
- Alternative Assets – Standard & Poor's 1500 Stock Composite Index
- Cash Equivalents – 90-day U.S. Treasury Bill rate
- *Hedge Fund – Directional – T-Bill Average Yield plus 4 percent and Standard & Poor's 500 Stock Composite Index*
- *Hedge Fund – Non-Directional – T-Bill Average Yield plus 3 percent and Lehman Brothers Aggregate Bond Index*
- *Private Equity – Standard & Poor's 500 Stock Composite Index plus 3 percent.*
- *Real Estate – 90 percent NCREIF Property Index and 10 percent NAREIT Property Index*

COMPTROLLER OF PUBLIC ACCOUNTS—PERMANENT HIGHER EDUCATION FUND

FUND PURPOSE

The Permanent Higher Education Fund (PHEF) was created in fiscal year 1996 to establish a permanent endowment fund for higher education institutions not eligible for the PUF. The legislature is required to deposit funds each year to the PHEF until its balance reaches \$2 billion. Once the fund reaches \$2 billion, investment income will be distributed to eligible institutions.

FUND CONTRIBUTIONS

General Revenue appropriations are added annually to the fund. According to the Comptroller of Public Accounts (CPA), no appropriations were added to the fund in fiscal year 2006.

FUND DISTRIBUTIONS

Currently no distributions are made from the fund. Once the fund balance reaches \$2 billion, investment income will be distributed each year to eligible institutions.

INVESTMENT OBJECTIVE

The primary investment objective, according to the CPA, is capital appreciation until the principal reaches \$2 billion. Investment decisions must adhere to the “prudent investor” rule.

INVESTMENT AND OVERSIGHT RESPONSIBILITY

The CPA, through the Texas Treasury Safekeeping Trust Company, is responsible for management and oversight of the fund.

PERCENTAGE OF ASSETS EXTERNALLY MANAGED/ ADVISED

Internal staff manages investment grade fixed-income investments and external managers manage equity, high-yield fixed-income, hedge fund, private equity, and real estate investments. According to the CPA, approximately 96.0 percent of the fund assets are externally managed.

INVESTMENT COSTS

According to the CPA, total investment expenses for fiscal year 2006 were \$1.6 million or 0.3 percent of the ending fund balance and mostly include external costs. Investment expenses included costs for consulting, auditing, IT systems,

compliance monitoring, overhead, risk management, reporting, investment accounting, and investment management. Investment costs for fiscal year 2005 were \$1.0 million or 0.2 percent of the ending fund balance.

PERFORMANCE BENCHMARKS

The CPA provided the following benchmarks. The benchmarks shown in italics have been updated from fiscal year 2005.

- Fixed Income – Investment Grade – Lehman Brothers Aggregate Bond Index
- Fixed Income – High Yield – Merrill Lynch High Yield Bond Index
- Domestic Equities – Large/Mid Cap – 90 percent Standard & Poor’s 500 Stock Composite Index plus 10 percent Standard & Poor’s 400 Stock Composite Index
- International Equities – Europe, Australia and Far East (EAFE) Index
- Alternative Assets – Standard & Poor’s 1500 Stock Composite Index
- Cash Equivalents – 90-day U.S. Treasury Bill rate
- *Hedge Fund – Directional – T-Bill Average Yield plus 4 percent and Standard & Poor’s 500 Stock Composite Index*
- *Hedge Fund – Non-Directional – T-Bill Average Yield plus 3 percent and Lehman Brothers Aggregate Bond Index*
- *Private Equity – Standard & Poor’s 500 Stock Composite Index plus 3 percent*
- *Real Estate – 90 percent NCREIF Property Index and 10 percent NAREIT Property Index*

APPENDIX C. GLOSSARY

ABSOLUTE RETURN HEDGE FUNDS

A marketable alternative investment which includes arbitrage and event oriented strategies and is often referred to as a “non-directional” fund. Arbitrage strategies attempt to take advantage of pricing discrepancies between closely related securities, utilizing a variety of different tactics primarily within equity, fixed income and convertible securities markets. Event driven strategies attempt to take advantage of pricing discrepancies that often exist during discreet events such as bankruptcies, mergers, takeovers, spin-offs and recapitalizations in equity and debt securities.

ACTIVE PORTFOLIO STRATEGY

A money-management approach based on informed, independent investment judgment as opposed to passive management (indexing). It attempts to outperform a benchmark index.

ALTERNATIVE INVESTMENTS

Investment opportunities which have not been identified by traditional public or fixed income capital markets. Also may be defined as private, nontraditional, illiquid investments. Alternative investments are accomplished almost exclusively through private offerings of debt equity interest, and are often made through entities organized as limited partnerships. Examples of alternative investments include international and emerging market stocks, hedge funds, event driven strategies, as well as illiquid equity investments such as venture capital, mezzanine financing, private equity and buy-out investing, real estate, and oil and gas.

ASSET ALLOCATION

The process of diversifying an investment portfolio among asset classes (stocks, bonds, real estate, etc.) in order to achieve a particular investment objective. Asset allocation is used to anticipate the long-term future direction of markets and to deploy assets in a way that will result in superior performance in the context of acceptable risks. Studies have shown that asset allocation has a far greater effect on investment performance than does the selection of investment managers or the selection of individual securities.

BASIS POINT (BP)

The smallest measure used in quoting investment performance or fees. One basis point is 1/100th of one percent. Thus, 100 basis points equals one percent. A bond’s yield that increased from 8.00 percent to 8.50 percent would be said to have risen 50 basis points. A management fee of 25 basis points represents 0.25 percent of value of the assets managed.

BENCHMARK

A reference that serves as a standard by which others may be measured. In the investment environment, the benchmark may be a common economic or financial index, such as the Consumer Price Index or the Standard & Poor’s 500 (S&P 500) Index.

BONDS

Contract to pay specified sum of money (the principal or face value) at a specified future date (maturity) plus interest paid at an agreed percentage of the principal. Maturity is usually longer than one year. The relationship between the bondholder and issuer of the bonds is that of creditor and debtor. Thus, the holder has no corporate ownership privileges as stockholders do.

BROKER

A person who acts as an intermediary between a buyer and seller, usually charging a commission.

CASH EQUIVALENTS

Investment instruments have such high liquidity and safety that they are virtually as good as cash. They typically have a short maturity. Examples include a money market fund, Treasury Bills, and investments in a custodian bank’s short term investment fund (STIF) or similar fund. Such securities help minimize risk during volatile market periods as well as to provide cash flow.

COLLATERALIZED MORTGAGE OBLIGATION (CMO)

A security created using the underlying cash flows from mortgage-backed securities as collateral. A CMO shifts the uncertainty regarding the exact timing of principal return in a mortgage-backed security. This uncertainty exists because the timing of mortgage-backed principal payments is

influenced by changes in interest rates, the current economic climate, and the geographic makeup of loans.

COMMON STOCK

Share in a public company or a privately held firm. Common stockholders typically have voting and dividend rights. In the event of corporate bankruptcy or other liquidation of assets, common stockholders are paid after secured and unsecured creditors, bond holders, and preferred stockholders.

CORPUS

The principal of a fund or estate as distinct from income or interest.

CREDIT RISK

The likelihood that a party involved in an investment transaction will not fulfill its obligations. This type of risk is often associated with the issuer of the investment security and is affected by the concentration of deposits or investments in a single instrument or with a single institution.

CUSTODIAN BANK

Used by an entity with large investment holdings to hold securities, record transactions, and collect interest or dividends from investments. The custodian bank is sometimes referred to as the primary or master custodian because it obtains the services of subcontractors and agencies to actually hold and trade the securities.

DERIVATIVES

A contract or financial arrangement whose value is based on the performance of an underlying financial asset, index, or other investment. Derivatives are available based on the performance of assets, interest rates, currency exchange rates, and various domestic and foreign indexes.

DIVERSIFICATION

The spreading of risk by investing in several individual investments or categories of investments, such as stocks, bonds, cash equivalents, and real estate.

DURATION

A concept that measures bond price volatility by measuring the “length” of a bond. It is a weighted average term to maturity of the bond’s cash flows, the weights being the present value of each cash flow as a percentage of the bond’s full price. The greater the duration of a bond, the greater its percentage price volatility. In general, duration rises with

maturity, falls with the frequency of coupon payments, and falls as the yield rises.

ENDOWMENT

Funds given to an entity, such as a college or university, with donor-imposed restrictions that the funds are not to be expended but are to be invested for purpose of producing income.

EQUITY HEDGE FUNDS

A marketable alternative investment which includes U.S. and international long/short equity strategies and is often referred to as a “directional” fund. These strategies attempt to take advantage of profits from stock selection skills by taking long positions in securities that are expected to advance and short positions in securities where returns are expected to lag or decline.

EQUITY INVESTMENT

Ownership interest processed by shareholders in a corporation.

EXTERNAL MANAGER

A person or firm that makes investment portfolio decisions and executes transactions independently, subject to the overall restrictions agreed upon by contract between the fiduciary for the fund and the external manager.

FIXED INCOME INVESTMENTS

A security that pays a fixed rate of return in the form of interest or dividends, over a specified period of time and includes government, corporate, and municipal bonds, preferred stocks, and certain mortgage investments. This asset class is expected to provide regular, predictable income and greater stability of market value than available from equity investments. It is advantageous in times of low inflation, but does not protect holders against erosion of buying power in time of rising inflation because interest or dividend payment do not increase.

GENERAL PARTNER

Member of a partnership who is jointly and severally liable for all debts incurred by the partnership; or a managing partner of a limited partnership who is in charge of its operations. A general partner has unlimited liability.

HEDGE/HEDGING

A strategy used to offset investment risk. A perfect hedge is one eliminating the possibility of future gain or loss.

INDEMNIFICATION

An agreement to compensate another party for damage or loss. In securities lending programs, the program administrator may agree to indemnify the lender of securities for any losses caused by the failure of the borrower to return borrowed securities.

INDEX

A statistical composite that measures changes in the economy or in financial markets, often expressed in percentage changes from a base period. For example, the Consumer Price Index, which is composed of the prices of key goods and services, moves up or down as the rate of inflation changes. Other indexes measure the ups and downs of the stock, bond, and other investment markets. Common indexes include the New York Stock Exchange Index, Standard & Poor 500 Index, and the Shearson Lehman Aggregate Bond Index.

INVESTMENT ADVISOR

A person or service retained by the investing entity to provide investment advice for a fee. The advisors may present economic information such as expected changes in interest rates, current and future national or global economic growth, and other factors that may affect the economy in the future. Investment advisors also present industry information that may affect future decisions in selecting specific securities. The advisor may specialize in a particular kind of investment, such as emerging growth stocks or international stocks.

LARGE/MEDIUM/SMALL CAPS

Stocks of companies with market capitalization of \$500 million or less. Such stocks generally represent companies that are less well established, but are often faster growing than mid-caps (market capitalization of \$500 million to \$3-5 billion) or large caps (\$1 billion or more). They are often more volatile than stocks of more well-established companies.

LEVERAGED BUYOUT

Equity investments in public or private companies that result in the purchase of a significant portion or majority control of the company.

LIQUIDITY

The ease with which an asset can be converted to money. Also, the ability to buy or sell an asset quickly and in large volume without substantially affecting the price.

MARKET RISK

The risk that the value of a security will rise or decline as a result of changes in market conditions.

MATURITY

The date on which a debt's principal is to be repaid.

MEZZANINE FINANCING

Investment in the subordinated debt of privately owned companies. The debt holder participates in equity appreciation through conversion features such as rights, warrants, or options.

MERRILL LYNCH 90-DAY U.S. TREASURY BILL INDEX

A benchmark which assumes that treasury bills are bought at the beginning of a period at market value and held to maturity. Upon maturity, it is assumed that additional bills are purchased at market value and again held until maturity. The rollover continues until the end of the period. The calculation includes the sum of the yields earned by the treasury bills.

MODERN PORTFOLIO THEORY

An investment decision approach that permits an investor to classify, estimate, and control both the kind and the amount of expected risk and return. Portfolio theory quantifies the relationship between risk and return and assumes that investors must be compensated for assuming risk. It departs from traditional security analysis by determining the statistical relationships among securities comprising the overall portfolio rather than analyzing the characteristics of individual investments.

MUTUAL FUND

Portfolio of securities professionally managed by the sponsoring management company or investment company that issues shares to investors. The major advantages of mutual funds are diversification, professional management, and ownership of a variety of securities with a minimal capital investment.

PASSIVE PORTFOLIO STRATEGY

A money-management strategy that seeks to match rather than outperform return and risk characteristics of a market segment or index, by mirroring its composition.

PEER GROUP

One group that is of equal standing with another group. In comparing an investment fund's performance with its peers, the peer group should include other funds with similar characteristics, such as fund size, purpose, and investment restrictions.

PORTFOLIO

A combined holding of more than one investment. The purpose of a portfolio is to reduce risk by diversification.

PRIVATE INVESTMENTS

Investment opportunities, which have not been identified by traditional capital markets. Typically more volatile than traditional securities, private investments require strong due diligence controls.

PRIVATE PLACEMENT

A securities issuance, which is exempt from registration requirements of the Securities Act of 1933. It generally involves the sale of stocks, bonds, or other investments directly to an institutional investor.

PRUDENT INVESTOR STANDARD

This standard provides that a board or other fiduciary in making investments, may acquire or retain any kind of investment that prudent investors, exercising reasonable care, skill, and caution, would acquire or retain in light of the purposes, terms, distribution requirements, and other circumstances of the fund then prevailing, taking into consideration the investment of all the assets of the fund rather than a single investment. Generally, this standard assumes that the board or other fiduciary has investment knowledge and expertise, and provides broader investment authority than the prudent person standard.

PRUDENT PERSON STANDARD

A concept born from the 1830 Massachusetts court decision of *Harvard College v. Armory* that described the duty owned by a trustee to beneficiaries: "All that can be required of a trustee to invest is, that he shall conduct himself faithfully and exercise sound discretion. He is to observe how men of prudence, discretion, and intelligence manage their own

affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income, as well as the probable safety of the capital to be invested."

RISK

In exchange for a return on investment, the investor may expose assets to possible losses. Risk is the probability or possibility of such losses. Risk is also often defined in terms of market volatility, or standard deviations of returns. The standard deviation is a statistical measure of portfolio risk, which reflects the average deviation of observations from their sample mean. It is used as an estimate of risk because it measures how wide the range of returns typically is. The wider the range of returns, the higher the portfolio risk.

S&P 500

An index, which measures the performance of the common stock of 500 of the largest U.S. corporations. The S&P 500 represents the aggregate market value changes relative to a base period of 500 stocks primarily traded on the New York Exchange.

S&P 1500

The S&P 1500 Composite Index, which measures the performance of the top 1500 U.S. companies.

SECURITIES LENDING

A program in which institutional investors transfer their securities to broker-dealers and other borrowers in exchange for collateral and a promise by the borrower to return the identical securities. The collateral may consist of cash, securities, or letters of credit. The lender agrees to the collateral to the borrower upon maturity of the loan and return of the borrowed securities.

TIME-WEIGHTED RATE OF RETURN

The total rate of return on an investment adjusted to eliminate the effect of timing of cash flows due to contributions and withdrawals, which are not controllable by investment managers.

TOTAL RETURN

The annual return on an investment including appreciation and interest or dividends. A "total return fund" is one that is indifferent to whether the return is generated by appreciation or ordinary income because it can spend from both categories.

TRANCHE

A class into which a multi-class security, such as collateralized mortgage obligation (CMO) is split. The different tranches of a CMO, which may range from a fast-pay class to long-term slow-pay class, are designed to meet different investor objectives for portfolio diversification.

VENTURE CAPITAL

Venture capital is an important source of financing for start-up companies or other embarking on a new or turnaround ventures that entail some investment risk but offer the potential for above average future profits. Sources of venture capital include wealthy individual investors, subsidiaries of banks and other corporations organize as small business investment companies: groups of investment banks and other financing sources that pool investments in venture capital funds or venture capital limited partnerships. Some venture capital sources invest only at a certain stage of entrepreneurship, such as the start-up or seed money stage, the first round or second round phases that follow, or at the mezzanine level immediately preceding an initial public offering. In return for taking an investment risk, the venture capitalists are usually rewarded with some combination of profits, preferred stock, royalties on sales, and capital appreciation of common shares.

VOLATILITY

The extent to which a security or market tends to rise or fall sharply in price within short-term period.

YIELD

The annual return on investment (from dividends or interest) expressed as a percentage of either cost or current price. Yield is one component of return.

Primary Source: "A Summary of the State's Investments", prepared by the State Auditor's Office for the Senate Finance Committee, October 1999.

APPENDIX D. REFERENCES

The following investing agencies and institutions of higher education provided information contained in the Annual Report on Major State Investment Funds.

Teacher Retirement System (TRS)

Permanent School Fund (PSF)

Employees Retirement System (ERS)

The University of Texas System (UT System)

Permanent University Fund (UT-PUF)

Permanent Health Fund (UT-PHF)

Comptroller of Public Accounts

Tobacco Settlement Permanent Trust (CPA-TSF)

Texas Guaranteed Tuition Plan Fund (CPA-TGTF)

Permanent Public Health Fund (CPA-PHF)

Permanent Higher Education Fund (CPA-PHEF)

Remittances of original data from agencies and institutions of higher education for this report are attached.

ATTACHMENT 1. TEACHER RETIREMENT SYSTEM PENSION FUND

| | | | | | |
|--|--|--|--|--|--|
| | Market Value of Fund Year Ending Aug. 31, 2006 \$ in millions | | | | |
| Total Fund | \$101,258.1 | | | | |
| | Fiscal Year 2006 Time Weighted Gross Fund Return | | Fiscal Year 2006 Benchmark Adjusted Gross Fund Return | | |
| Total Fund | 9.70% | | 9.32% | | |
| | Fiscal Year Fiscal Year Fiscal Year Fiscal Year Fiscal Year | | | | |
| | 2006 2005 2004 2003 2002 | | | | |
| Gross Return - Total Fund | 9.70% 14.41% 11.91% 11.28% -7.81% | | | | |
| Gross Return - Equity (For Fiscal Year 2006 only) | 12.08% 18.35% 13.73% 13.32% -14.83% | | | | |
| % of Domestic Equity Internally Managed | 100% | | | | |
| Rate of Return for Internally Managed % of Domestic Equity Externally Managed | 12.08% 0% | | | | |
| Rate of Return for Externally Managed | n/a | | | | |
| Gross Return- Fixed Income | 2.16% 4.78% 7.96% 5.75% 8.24% | | | | |
| Gross Return - Cash & Short-term | 4.52% 2.53% 1.28% 1.63% 2.43% | | | | |
| Gross Return - All Other | 22.92% 28.02% 10.84% 8.11% -6.62% | | | | |
| | Market Value Market Value Market Value Market Value Market Value | | | | |
| | of Fund of Fund of Fund of Fund of Fund | | | | |
| | Year Ending Year Ending Year Ending Year Ending Year Ending | | | | |
| | Aug. 31, 2006 Aug. 31, 2005 Aug. 31, 2004 Aug. 31, 2003 Aug. 31, 2002 | | | | |
| | \$ in millions \$ in millions \$ in millions \$ in millions \$ in millions | | | | |
| Portfolio Diversification | | | | | |
| All Equity | \$65,836 \$63,571 \$55,836 \$52,697 \$47,159 | | | | |
| All Fixed Income | \$27,183 \$24,723 \$23,070 \$21,282 \$21,937 | | | | |
| All Cash & Short Term Securities | \$3,975 \$1,921 \$3,027 \$650 \$155 | | | | |
| All Other Investments | \$4,263 \$3,114 \$2,478 \$1,991 \$1,590 | | | | |
| | Total Fiscal Year 2006 | | | | |
| Fund Contributions | | | | | |
| Members | \$1,700,415,419 | | | | |
| State | \$1,332,101,481 | | | | |
| Reporting Employers | \$267,399,619 | | | | |
| Member Reinstatements | \$154,599,147 | | | | |
| Investment Income | \$8,950,869,951 | | | | |
| Total Contributions | \$12,405,385,617 | | | | |
| Fund Distributions | | | | | |
| Benefits | \$5,581,264,678 | | | | |
| Refunds | \$265,487,479 | | | | |
| Other | \$27,486,366 | | | | |
| Total Distributions | \$5,874,238,523 | | | | |
| Internal Investment Expenses: | | | | | |
| Direct | \$13,239,784 | | | | |
| Indirect | \$5,859,611 | | | | |
| External Investment Expenses: | \$0 | | | | |
| Total Investment Expenses: | \$19,099,395 | | | | |
| | Year Ending Aug. 31, 2006 | | | | |
| Percentage of Assets Externally Managed | 0% | | | | |

ATTACHMENT 2. PERMANENT SCHOOL FUND

| | Market Value of Fund Year Ending Aug. 31, 2006 \$ in millions | | | | |
|--|--|--|--|--|--|
| Total Fund | | | | | |
| | Fiscal Year 2006 Time Weighted Gross Fund Return | Fiscal Year 2006 Benchmark Adjusted Gross Fund Return | Fiscal Year 2006 | Fiscal Year 2005 | Fiscal Year 2004 |
| Total Fund | 10.44% | 9.82% | | | |
| | Fiscal Year 2006 | Fiscal Year 2005 | Fiscal Year 2004 | Fiscal Year 2003 | Fiscal Year 2002 |
| Gross Return - Total Fund | 10.44% | 14.18% | 10.57% | 10.51% | -6.65% |
| Gross Return - Equity (For Fiscal Year 2006 only) | 12.84% | 17.54% | 13.38% | 13.06% | -18.07% |
| % of Domestic Equity Internally Managed | 100.00% | | | | |
| Rate of Return for Internally Managed | 8.50% | | | | |
| % of Domestic Equity Externally Managed | 0.00% | | | | |
| Rate of Return for Externally Managed | n/a | | | | |
| Gross Return- Fixed Income | 1.74% | 4.11% | 6.31% | 6.04% | 8.39% |
| Gross Return - Cash & Short-term | | | | | |
| Gross Return - All Other | | | | | |
| | Market Value of Fund Year Ending Aug. 31, 2006 \$ in millions | Market Value of Fund Year Ending Aug. 31, 2005 \$ in millions | Market Value of Fund Year Ending Aug. 31, 2004 \$ in millions | Market Value of Fund Year Ending Aug. 31, 2003 \$ in millions | Market Value of Fund Year Ending Aug. 31, 2002 \$ in millions |
| Portfolio Diversification | | | | | |
| All Equity | \$17,153 | \$16,318 | \$14,418 | \$10,664 | \$8,563 |
| All Fixed Income | \$5,661 | \$5,042 | \$4,859 | \$7,625 | \$8,618 |
| All Cash & Short Term Securities | \$72 | \$74 | \$61 | | |
| All Other Investments | | | | | |
| Totals | \$22,886 | \$21,433.4 | \$19,337.7 | \$18,289.1 | \$17,180.5 |
| | Total Fiscal Year 2006 | | | | |
| Fund Contributions | \$121,722,457 | | | | |
| Fund Distributions | \$841,878,709 | | | | |
| Internal Investment Expenses: | | | | | |
| Direct | \$4,719,693 | | | | |
| Indirect | | | | | |
| External Investment Expenses: | \$683,960 | | | | |
| Total Investment Expenses: | \$5,403,653 | | | | |
| | Year Ending Aug. 31, 2006 | | | | |
| Percentage of Assets Externally Managed | 19.65% | | | | |

ATTACHMENT 3. EMPLOYEES RETIREMENT SYSTEM—PENSION TRUST FUND

| | Market Value of Fund Year Ending Aug. 31, 2006 \$ in millions | | | | |
|--|--|--|--|--|--|
| Total Fund | \$22,378.08 | | | | |
| | Fiscal Year 2006 Time Weighted Gross Fund Return | Fiscal Year 2006 Benchmark Adjusted Gross Fund Return | | | |
| Total Fund | 8.83% | 8.99% | | | |
| | Fiscal Year 2006 | Fiscal Year 2005 | Fiscal Year 2004 | Fiscal Year 2003 | Fiscal Year 2002 |
| Gross Return - Total Fund | 8.83% | 12.71% | 11.69% | 9.20% | -7.17% |
| Gross Return - Equity (For Fiscal Year 2006 only) | 12.45% | 17.61% | 14.31% | 10.10% | -16.47% |
| % of Domestic Equity Internally Managed | 28.48% | | | | |
| Rate of Return for Internally Managed | 10% | | | | |
| % of Domestic Equity Externally Managed | 15.51% | | | | |
| Rate of Return for Externally Managed | 5% | | | | |
| Gross Return- Fixed Income | 2.52% | 5.21% | 7.78% | 6.50% | 6.17% |
| Gross Return - Cash & Short-term | 4.66% | 2.54% | 1.10% | 1.40% | 2.33% |
| Gross Return - All Other | 20.46% | 6.24% | 5.15% | -13.52% | n/a |
| | Market Value of Fund Year Ending Aug. 31, 2006 \$ in millions | Market Value of Fund Year Ending Aug. 31, 2005 \$ in millions | Market Value of Fund Year Ending Aug. 31, 2004 \$ in millions | Market Value of Fund Year Ending Aug. 31, 2003 \$ in millions | Market Value of Fund Year Ending Aug. 31, 2002 \$ in millions |
| Portfolio Diversification | | | | | |
| All Equity | \$14,126.56 | \$13,274.89 | \$11,412.20 | \$10,955.70 | \$9,507.04 |
| All Fixed Income | \$8,119.29 | \$7,853.46 | \$8,046.97 | \$7,083.09 | \$7,476.80 |
| All Cash & Short Term Securities | \$96.94 | \$65.93 | \$6.49 | \$8.03 | \$6.22 |
| All Other Investments | \$35.27 | \$57.96 | \$57.19 | \$69.39 | \$58.09 |
| Totals | \$22,378.06 | \$21,252.2 | \$19,522.9 | \$18,116.2 | \$17,048.2 |
| | Total Fiscal Year 2006 | | | | |
| Fund Contributions | \$2,462.75 | | | | |
| Fund Distributions | \$1,342.98 | | | | |
| Internal Investment Expenses: | \$5.23 | | | | |
| Direct | \$3.54 | | | | |
| Indirect | \$1.65 | | | | |
| External Investment Expenses: | \$13.81 | | | | |
| Total Investment Expenses: | \$19.04 | | | | |
| | Year Ending Aug. 31, 2006 | | | | |
| Percentage of Assets Externally Managed | 35.6% | | | | |

ATTACHMENT 4. THE UNIVERSITY OF TEXAS SYSTEM—PERMANENT UNIVERSITY FUND

| | | | | | |
|--|---|--|---|---|---|
| | Market Value of Fund Year Ending Aug. 31, 2006 \$ in millions | | | | |
| Total Fund | \$10,313.4 | | | | |
| | Fiscal Year 2006 Time Weighted Gross Fund Return | | Fiscal Year 2006 Benchmark Adjusted Gross Fund Return | | |
| Total Fund | 11.56% | | 12.51% | | |
| | Fiscal Year 2006 | Fiscal Year 2005 | Fiscal Year 2004 | Fiscal Year 2003 | Fiscal Year 2002 |
| Gross Return - Total Fund | 11.56% | 19.05% | 14.98% | 12.22% | -7.19% |
| Gross Return - Equity (For Fiscal Year 2006 only) | 12.61% | 19.56% | 15.26% | 17.69% | -12.90% |
| % of Domestic Equity Internally Managed | 55.70% | | | | |
| Rate of Return for Internally Managed | 11.85% | | | | |
| % of Domestic Equity Externally Managed | 44.30% | | | | |
| Rate of Return for Externally Managed | 9.56% | | | | |
| Foreign | 21.02% | 26.55% | 20.58% | 17.30% | -11.14% |
| Gross Return- Fixed Income | 2.42% | 6.67% | 9.82% | 6.84% | 7.11% |
| Gross Return - Cash & Short-term | 16.45% | 2.48% | 1.06% | 1.34% | 2.29% |
| Gross Return - All Other | | | | | |
| Absolute Return | 9.11% | 14.52% | 13.02% | 21.12% | -4.04% |
| Equity Hedge | 6.24% | 13.23% | 11.17% | 4.30% | -0.37% |
| Non-Marketable | 23.02% | 30.00% | 13.03% | -6.25% | -15.41% |
| Commodities | -4.41% | 32.29% | 18.32% | 21.76% | See Note 1 |
| | Market Value of Fund Year Ending Aug. 31, 2006 \$ in millions | Market Value of Fund Year Ending Aug. 31, 2005 \$ in millions | Market Value of Fund Year Ending Aug. 31, 2004 \$ in millions | Market Value of Fund Year Ending Aug. 31, 2003 \$ in millions | Market Value of Fund Year Ending Aug. 31, 2002 \$ in millions |
| Portfolio Diversification | | | | | |
| All Equity | \$4,877.2 | \$4,278.2 | \$3,701.1 | \$3,882.9 | \$3,262.4 |
| Domestic | \$2,750.8 | \$2,612.9 | \$2,228.6 | \$2,537.9 | \$2,269.7 |
| Foreign | \$2,126.4 | \$1,665.3 | \$1,472.5 | \$1,345.0 | \$992.7 |
| All Fixed Income | \$1,519.1 | \$1,406.2 | \$1,195.3 | \$1,033.3 | \$1,410.3 |
| All Cash & Short Term Securities | \$74.1 | \$176.8 | \$294.9 | \$154.5 | \$151.1 |
| All Other Investments | \$3,843.0 | \$3,565.5 | \$2,896.6 | \$2,174.1 | \$1,914.5 |
| Absolute Return | \$1,511.0 | \$1,277.8 | \$1,057.0 | \$669.9 | \$477.9 |
| Equity Hedge | \$859.0 | \$917.3 | \$664.4 | \$561.8 | \$324.6 |
| Non-Marketable | \$981.1 | \$875.0 | \$794.0 | \$845.2 | \$933.0 |
| Commodities | \$491.9 | \$495.4 | \$381.2 | \$97.2 | \$179.0 |
| Totals | \$10,313.4 | \$9,426.7 | \$8,087.9 | \$7,244.8 | \$6,738.3 |
| | Total Fiscal Year 2006 | | | | |
| Fund Contributions | \$215.0 | PUF Land receipts | | | |
| Fund Distributions | \$357.3 | Distributed to Available University Fund | | | |
| Internal Investment Expenses: | | | | | |
| Direct | \$2.5 | | | | |
| Indirect | \$3.1 | Investment expense is made up of internal and external management fees, custodian, audit, consulting, performance, risk management, and securities lending fees. | | | |
| External Investment Expenses: | \$77.0 | | | | |
| Total Investment Expenses: | \$82.6 | | | | |
| | Year Ending Aug. 31, 2006 | | | | |
| Percentage of Assets Externally Managed | 75.02% | | | | |

Note 1: Not fully funded in this asset class during this fiscal year.

ATTACHMENT 5. THE UNIVERSITY OF TEXAS SYSTEM—PERMANENT HEALTH FUND

| | | | | | |
|---|--|--|-----------------------------|-----------------------------|-----------------------------|
| | Market Value of Fund Year Ending Aug. 31, 2006 \$ in millions | | | | |
| Total Fund | \$987.0 | | | | |
| | Fiscal Year 2006 Time Weighted Gross Fund Return | Fiscal Year 2006 Benchmark Adjusted Gross Fund Return | | | |
| Total Fund | 11.11% | 12.51% | | | |
| | Fiscal Year 2006 | Fiscal Year 2005 | Fiscal Year 2004 | Fiscal Year 2003 | Fiscal Year 2002 |
| PHF | | | | | |
| Gross Return - Total Fund | 11.11% | 18.75% | 14.69% | 12.78% | -6.99% |
| Gross Return - Equity (For Fiscal Year 2006 only) | <i>See Note 1</i> | <i>See Note 1</i> | <i>See Note 1</i> | <i>See Note 1</i> | <i>See Note 1</i> |
| % of Domestic Equity Internally Managed | 100.0% | | | | |
| % of Domestic Equity Externally Managed | 0.0% | | | | |
| Gross Return- Fixed Income | <i>See Note 1</i> | | | | |
| Gross Return - Cash & Short-term | 4.58% | 2.48% | 1.06% | 1.34% | 2.29% |
| Gross Return - All Other | <i>See Note 1</i> | <i>See Note 1</i> | <i>See Note 1</i> | <i>See Note 1</i> | <i>See Note 1</i> |
| | Fiscal Year 2006 | Fiscal Year 2005 | Fiscal Year 2004 | Fiscal Year 2003 | Fiscal Year 2002 |
| GEF | | | | | |
| Gross Return - Total Fund | 11.45% | 19.04% | 14.95% | 12.94% | |
| Gross Return - Equity | | | | | |
| Domestic | 12.68% | 19.65% | 14.96% | 17.89% | |
| (For Fiscal Year 2006 only) | | | | | |
| % of Domestic Equity Internally Managed | 51.38% | | | | |
| Rate of Return for Internally Managed | 12.89% | | | | |
| % of Domestic Equity Externally Managed | 48.62% | | | | |
| Rate of Return for Externally Managed | 9.50% | | | | |
| Foreign | 20.70% | | | | |
| Gross Return- Fixed Income | 2.50% | | | | |
| Gross Return - Cash & Short-term | 17.97% | | | | |
| Gross Return - All Other | | | | | |
| Absolute Return | 9.04% | 14.69% | 13.02% | 21.11% | |
| Equity Hedge | 6.15% | 13.17% | 11.09% | 4.20% | |
| Non-Marketable | 21.77% | 28.26% | 12.13% | -6.59% | |
| Commodities | -4.42% | 32.46% | 18.57% | 21.78% | |

ATTACHMENT 5. THE UNIVERSITY OF TEXAS SYSTEM—PERMANENT HEALTH FUND (CONTINUED)

| | Market Value of Fund Year Ending Aug. 31, 2006 \$ in millions | Market Value of Fund Year Ending Aug. 31, 2005 \$ in millions | Market Value of Fund Year Ending Aug. 31, 2004 \$ in millions | Market Value of Fund Year Ending Aug. 31, 2003 \$ in millions | Market Value of Fund Year Ending Aug. 31, 2002 \$ in millions |
|---|---|--|---|---|---|
| Portfolio Diversification | | | | | |
| All Equity | \$986.7 | \$925.7 | \$814.2 | \$744.8 | \$698.1 |
| All Fixed Income | | | | | |
| All Cash & Short Term Securities | \$0.3 | \$0.2 | \$0.2 | \$0.2 | \$0.1 |
| All Other Investments | | | | | |
| | Total Fiscal Year 2006 | | | | |
| Fund Contributions | - | | | | |
| Fund Distributions | \$39.5 | Distributed to unit holders of the fund | | | |
| Internal Investment Expenses: | \$0.7 | | | | |
| Direct | \$0.3 | | | | |
| Indirect | \$0.4 | | | | |
| External Investment Expenses: | - | | | | |
| Total Investment Expenses: | \$0.7 | | | | |
| Allocation from GEF | \$3.1 | | | | |
| Total Expense | \$3.8 | | | | |
| | Year Ending Aug. 31, 2006 | Investment expense is made up of internal and external management fees, custodian, audit, consulting, performance, risk management, and securities lending fees. | | | |
| Percentage of Assets Externally Managed | See Note 1 | | | | |

Note 1 - As of March 1, 2001, the PHF and LTF purchased units in the newly created General Endowment Fund (GEF) in exchange for their contribution of investment assets. The GEF, established by the Board of Regents effective March 1, 2001, is a pooled fund for the collective investment of long-term funds under the control and management of the Board. The GEF is organized as a mutual fund in which the PHF and LTF are the only unitholders. As of August 31, 2006, the PHF had a 18.2% ownership of the GEF. The returns by asset class for the GEF for fiscal year 2006 are shown above.

ATTACHMENT 6. COMPTROLLER OF PUBLIC ACCOUNTS—TOBACCO SETTLEMENT PERMANENT FUND

| | | | | | |
|--|--|--|--|--|--|
| | Market Value of Fund Year Ending Aug. 31, 2006 \$ in millions | | | | |
| Total Fund | \$2,178.5 | | | | |
| | Fiscal Year 2006 Time Weighted Gross Fund Return | Fiscal Year 2006 Benchmark Adjusted Gross Fund Return | | | |
| Total Fund | 10.20% | 10.35% | | | |
| | Fiscal Year 2006 | Fiscal Year 2005 | Fiscal Year 2004 | Fiscal Year 2003 | Fiscal Year 2002 |
| Gross Return - Total Fund | 10.20% | 15.48% | 11.64% | 12.27% | -8.42% |
| Gross Return - Equity (For Fiscal Year 2006 only) | 13.02% | 20.00% | 13.46% | 15.30% | -17.43% |
| % of Domestic Equity Internally Managed | 0.00% | | | | |
| Rate of Return for Internally Managed | 0.00% | | | | |
| % of Domestic Equity Externally Managed | 100.00% | | | | |
| Rate of Return for Externally Managed | 13.02% | | | | |
| Gross Return- Fixed Income | 2.23% | 4.29% | 6.08% | 2.28% | 7.98% |
| Gross Return - Cash & Short-term | 2.94% | 3.08% | 0.85% | 1.23% | 2.19% |
| Gross Return - All Other | | | | | |
| Gross Return - Absolute Return | 9.08% | n/a | n/a | n/a | n/a |
| Gross Return - Equity Hedge | 4.87% | n/a | n/a | n/a | n/a |
| Gross Return - Non-marketable | 7.02% | 3.27% | n/a | n/a | n/a |
| | Market Value of Fund Year Ending Aug. 31, 2006 \$ in millions | Market Value of Fund Year Ending Aug. 31, 2005 \$ in millions | Market Value of Fund Year Ending Aug. 31, 2004 \$ in millions | Market Value of Fund Year Ending Aug. 31, 2003 \$ in millions | Market Value of Fund Year Ending Aug. 31, 2002 \$ in millions |
| Portfolio Diversification | | | | | |
| All Equity | \$1,517.9 | \$1,441.0 | \$1,283.3 | \$1,222.3 | \$818.00 |
| All Fixed Income | \$383.1 | \$456.6 | \$518.6 | \$404.9 | \$425.0 |
| All Cash & Short Term Securities | \$31.5 | \$145.1 | \$25.6 | \$26.9 | \$72.0 |
| All Other Investments | \$246.0 | \$5.4 | - | - | - |
| Absolute Return | \$107.9 | n/a | n/a | n/a | n/a |
| Equity Hedge | \$104.1 | n/a | n/a | n/a | n/a |
| Non-marketable | \$34.0 | \$5.4 | n/a | n/a | n/a |
| Totals | \$2,178.5 | \$2,048.1 | \$1,827.5 | \$1,654.1 | \$1,315.0 |
| | Total Fiscal Year 2006 | | | | |
| Fund Contributions | - | | | | |
| Fund Distributions | \$72,070,600.00 | | | | |
| Internal Investment Expenses: | \$2,431,370.59 | | | | |
| Direct | \$2,431,370.59 | | | | |
| Indirect | | | | | |
| External Investment Expenses: | \$4,006,687.11 | | | | |
| Total Investment Expenses: | \$6,438,057.70 | | | | |
| | Year Ending Aug. 31, 2006 | | | | |
| Percentage of Assets Externally Managed | 96.0% | | | | |

ATTACHMENT 7. COMPTROLLER OF PUBLIC ACCOUNTS—TEXAS GUARANTEED TUITION PLAN FUND

| | | | | | |
|--|--|--|--|--|--|
| | Market Value of Fund Year Ending Aug. 31, 2006 \$ in millions | | | | |
| Total Fund | \$1,715.1 | | | | |
| | Fiscal Year 2006 Time Weighted Gross Fund Return | Fiscal Year 2006 Benchmark Adjusted Gross Fund Return | | | |
| Total Fund | 8.7% | 8.5% | | | |
| | Fiscal Year 2006 | Fiscal Year 2005 | Fiscal Year 2004 | Fiscal Year 2003 | Fiscal Year 2002 |
| Gross Return - Total Fund | 8.7% | 14.3% | 10.3% | 6.9% | -3.3% |
| Gross Return - Equity (For Fiscal Year 2006 only) | 12.2% | 21.2% | 16.8% | 9.2% | -10.7% |
| % of Domestic Equity Internally Managed | 0.0% | | | | |
| Rate of Return for Internally Managed | n/a | | | | |
| % of Domestic Equity Externally Managed | 100.0% | | | | |
| Rate of Return for Externally Managed | 7.6% | | | | |
| Gross Return- Fixed Income | 2.9% | 4.7% | 5.3% | 3.2% | 8.3% |
| Gross Return - Cash & Short-term | 4.3% | 2.5% | 0.5% | 1.4% | 1.9% |
| Gross Return - All Other | n/a | n/a | n/a | n/a | n/a |
| | Market Value of Fund Year Ending Aug. 31, 2006 \$ in millions | Market Value of Fund Year Ending Aug. 31, 2005 \$ in millions | Market Value of Fund Year Ending Aug. 31, 2004 \$ in millions | Market Value of Fund Year Ending Aug. 31, 2003 \$ in millions | Market Value of Fund Year Ending Aug. 31, 2002 \$ in millions |
| Portfolio Diversification | | | | | |
| All Equity | \$1,077 | \$946 | \$789 | \$562 | \$441 |
| All Fixed Income | \$596 | \$503 | \$410 | \$317 | \$284 |
| All Cash & Short Term Securities | \$42 | \$131 | \$146 | \$253 | \$102 |
| All Other Investments | - | - | - | - | - |
| Totals | \$1,751.1 | \$1,580.0 | \$1,345.0 | \$1,132.1 | \$827.0 |
| | Total Fiscal Year 2006 | | | | |
| Fund Contributions: | | | | | |
| Prepaid Tuition Contract Payments | \$102,150,954 | | | | |
| Application Fees & Other Income | \$17,554 | | | | |
| Investment Income | \$135,358,952 | | | | |
| Total Fund Contributions | \$237,527,460 | | | | |
| Fund Distributions: | | | | | |
| Tuition Payments to Colleges | \$75,194,598 | | | | |
| Administrative Expenses | \$8,091,505 | | | | |
| Refunds to Contract Purchasers | \$19,523,300 | | | | |
| Total Fund Distributions | \$102,809,403 | | | | |
| Internal Investment Expenses: | \$10,000 | | | | |
| Direct | - | | | | |
| Indirect | \$10,000 | | | | |
| External Investment Expenses: | \$6,573,993 | | | | |
| Total Investment Expenses: | \$6,583,993 | | | | |
| | Year Ending Aug. 31, 2006 | | | | |
| Percentage of Assets Externally Managed | 100.0% | | | | |

ATTACHMENT 8. COMPTROLLER OF PUBLIC ACCOUNTS—PERMANENT PUBLIC HEALTH FUND

| | | | | | |
|--|--|--|--|--|--|
| | Market Value of Fund Year Ending Aug. 31, 2006 \$ in millions | | | | |
| Total Fund | \$477.8 | | | | |
| | Fiscal Year 2006 Time Weighted Gross Fund Return | Fiscal Year 2006 Benchmark Adjusted Gross Fund Return | | | |
| Total Fund | 9.86% | 10.37% | | | |
| | Fiscal Year 2006 | Fiscal Year 2005 | Fiscal Year 2004 | Fiscal Year 2003 | Fiscal Year 2002 |
| Gross Return - Total Fund | 9.86% | 15.74% | 11.60% | 13.08% | -10.19% |
| Gross Return - Equity (For Fiscal Year 2006 only) | 13.15% | 19.56% | 12.84% | 14.89% | -17.36% |
| % of Domestic Equity Internally Managed | 0.00% | | | | |
| Rate of Return for Internally Managed % of Domestic Equity Externally Managed | 0.00% | | | | |
| Rate of Return for Externally Managed | 100.00% | | | | |
| Gross Return - Fixed Income | 13.15% | | | | |
| Gross Return - Cash & Short-term | 2.25% | 4.31% | 6.65% | 2.27% | 7.36% |
| Gross Return - All Other | 2.94% | 3.67% | 0.96% | 1.23% | 2.19% |
| Gross Return - Absolute Return | 9.08% | -4.69% | -14.55% | -19.73% | 0.00% |
| Gross Return - Equity Hedge | 4.87% | n/a | n/a | n/a | n/a |
| Gross Return - Non-marketable | -9.68% | n/a | n/a | n/a | n/a |
| | Market Value of Fund Year Ending Aug. 31, 2006 \$ in millions | Market Value of Fund Year Ending Aug. 31, 2005 \$ in millions | Market Value of Fund Year Ending Aug. 31, 2004 \$ in millions | Market Value of Fund Year Ending Aug. 31, 2003 \$ in millions | Market Value of Fund Year Ending Aug. 31, 2002 \$ in millions |
| Portfolio Diversification | | | | | |
| All Equity | \$334.1 | \$316.0 | \$306.0 | \$277.6 | \$234.9 |
| All Fixed Income | \$79.9 | \$100.1 | \$93.5 | \$93.4 | \$96.0 |
| All Cash & Short Term Securities | \$6.8 | \$31.8 | \$6.1 | \$6.2 | \$23.0 |
| All Other Investments | \$57.0 | \$5.6 | \$3.8 | \$4.3 | \$4.1 |
| Absolute Return | \$23.7 | n/a | n/a | n/a | n/a |
| Equity Hedge | \$22.8 | n/a | n/a | n/a | n/a |
| Non-marketable | \$10.5 | \$5.6 | \$3.8 | \$4.3 | \$4.1 |
| Totals | \$477.8 | \$453.5 | \$409.4 | \$381.5 | \$358.0 |
| | Total Fiscal Year 2006 | | | | |
| Fund Contributions | \$0.0 | | | | |
| Fund Distributions | \$18,382,078.08 | | | | |
| Internal Investment Expenses: | \$530,671.86 | | | | |
| Direct | \$530,671.86 | | | | |
| Indirect | | | | | |
| External Investment Expenses: | \$887,106.29 | | | | |
| Total Investment Expenses: | \$1,417,778.15 | | | | |
| | Year Ending Aug. 31, 2006 | | | | |
| Percentage of Assets Externally Managed | 96.1% | | | | |

ATTACHMENT 9. COMPTROLLER OF PUBLIC ACCOUNTS—PERMANENT HIGHER EDUCATION FUND

| | Market Value of Fund Year Ending Aug. 31, 2006 \$ in millions | | | | |
|--|--|--|--|--|--|
| Total Fund | \$542.0 | | | | |
| | Fiscal Year 2006 Time Weighted Gross Fund Return | Fiscal Year 2006 Benchmark Adjusted Gross Fund Return | | | |
| Total Fund | 9.68% | 10.37% | | | |
| | Fiscal Year 2006 | Fiscal Year 2005 | Fiscal Year 2004 | Fiscal Year 2003 | Fiscal Year 2002 |
| Gross Return - Total Fund | 9.68% | 16.59% | 11.82% | 13.39% | -10.71% |
| Gross Return - Equity | 13.07% | 20.58% | 13.11% | 16.26% | -17.72% |
| (For Fiscal Year 2006 only) | | | | | |
| % of Domestic Equity Internally Managed | 0.00% | | | | |
| Rate of Return for Internally Managed | 0.00% | | | | |
| % of Domestic Equity Externally Managed | 100.00% | | | | |
| Rate of Return for Externally Managed | 13.07% | | | | |
| Gross Return - Fixed Income | 2.23% | 4.33% | 7.04% | 2.28% | 7.39% |
| Gross Return - Cash & Short-term | 2.94% | 3.72% | 0.97% | 1.13% | 2.19% |
| Gross Return - All Other | | | | | |
| Gross Return - Absolute Return | 9.08% | n/a | n/a | n/a | n/a |
| Gross Return - Equity Hedge | 4.87% | n/a | n/a | n/a | n/a |
| Gross Return - Non-marketable | -12.78% | -5.65% | -14.55% | -19.73% | 0.00% |
| | Market Value of Fund Year Ending Aug. 31, 2006 \$ in millions | Market Value of Fund Year Ending Aug. 31, 2005 \$ in millions | Market Value of Fund Year Ending Aug. 31, 2004 \$ in millions | Market Value of Fund Year Ending Aug. 31, 2003 \$ in millions | Market Value of Fund Year Ending Aug. 31, 2002 \$ in millions |
| Portfolio Diversification | | | | | |
| All Equity | \$376.0 | \$344.0 | \$329.9 | \$272.9 | \$191.6 |
| All Fixed Income | \$95.0 | \$109.0 | \$84.2 | \$92.5 | \$67.1 |
| All Cash & Short Term Securities | \$7.7 | \$34.6 | \$6.5 | \$6.2 | \$38.6 |
| All Other Investments | \$63.3 | \$7.9 | \$5.7 | \$6.4 | \$6.2 |
| Absolute Return | \$25.8 | n/a | n/a | n/a | n/a |
| Equity Hedge | \$24.9 | n/a | n/a | n/a | n/a |
| Non-marketable | \$12.6 | \$7.9 | \$5.7 | \$6.4 | \$6.2 |
| Totals | \$542.0 | \$495.5 | \$426.3 | \$378.0 | \$303.5 |
| | Total Fiscal Year 2006 | | | | |
| Fund Contributions | \$0.00 | | | | |
| Fund Distributions | \$0.00 | | | | |
| Internal Investment Expenses: | \$607,565.09 | | | | |
| Direct | \$607,565.09 | | | | |
| Indirect | | | | | |
| External Investment Expenses: | \$969,315.23 | | | | |
| Total Investment Expenses: | \$1,576,880.32 | | | | |
| | Year Ending Aug. 31, 2006 | | | | |
| Percentage of Assets Externally Managed | 96.0% | | | | |